FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 218

EMORY W. PARSONS, EMMA M. PARSONS, HOWARD H. PARSONS, ET AL., *Petitioners*,

v.

FRANCIS B. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF PARAGON JEWEL COAL COMPANY, INC., AS AMICUS CURIAE.

FREDERICK BERNAYS WIENER,
Suite 815 Stoneleigh Court,
1625 Connecticut Ave., N. W.,
Washington 6, D. C.,
Counsel for Amicus Curiae.

E. ROY KAZEL,
Kaz Building,
Bluefield, W. Va.,
Of Counsel.

INDEX

	Page
Interest of *Amicus Curiae*	1
Operations and business of *Amicus Curiae*	4
Summary of Argument	9
Argument	13
I. The depletion allowance is a form of depreciation allowance, and is available only to those who have an economic interest, acquired by investment, in the wasting capital asset of minerals in place	15
II. The essential prerequisite to the right to deduct for depletion—an economic interest in the mineral in place representing a capital investment—has been distorted by the Fourth Circuit to the point of abandonment	25
III. The result below is clearly right on the basis of the facts and of the settled administrative rulings applying to those facts	34
A. Petitioners are not entitled to a depletion allowance because they have neither made nor acquired any capital investment in the coal in place	34
B. Petitioners are not entitled to a depletion allowance because their compensation was at a fixed price without regard to the market, so that they were paid simply for mining coal belonging to another rather than disposing of an asset in which they had invested and therefore owned	38
C. Petitioners are not entitled to a depletion allowance because their contracts were terminable at the will of the owner of the coal lands	39
D. Petitioners' contracts here were non-exclusive, but the factor of exclusiveness, even if present, would not entitle them to any depletion allowance	41

Page

E. Petitioners' contracts here did not call for exhaustion of the deposit where they were operating, but even contracts providing for mining to exhaustion do not by reason of that factor alone entitle the stripper to percentage depletion 42

F. Petitioners are not entitled to percentage depletion under applicable Treasury regulations and interpretations 44

IV. The legislation which since 1951 has permitted the lessor of coal lands to capitalize his royalty income as a substitute for a share of the depletion allowance constitutes an additional reason why a mere contractor is not entitled to any portion of such allowance 47

Conclusion 57

Appendix A—Form of typical Paragon Jewel Coal lease 1a

Appendix B—Form of Paragon Jewel drift mining contract 9a

AUTHORITIES

Cases:

Anderson v. *Helvering*, 310 U.S. 404 26
Helen C. Brown, 22 T.C. 58 ..... 35, 39
Burton-Sutton Oil Co. v. *Commissioner*, 328 U.S. 25 ..... 26, 27, 28
Commissioner of Int. Rev. v. *American Gilsonite Co.*, 259 F. 2d 654 14
Commissioner of Internal Rev. v. *Gregory Run Coal Co.*, 212 F. 2d 52, certiorari denied, 348 U.S. 828 ..... 27, 28, 31, 36, 54
Commissioner of Internal Rev. v. *Hamill Coal Corp.*, 239 F. 2d 347 ..... 31, 36, 41, 43
Commissioner of Internal Rev. v. *Mammoth Coal Co.*, 229 F. 2d 535, certiorari denied, 352 U.S. 824 ..... 28, 29, 31, 36, 40, 41, 43

Page

Commissioner v. *Southwest Expl. Co.*, 350 U.S. 308 3, 10, 25, 33, 53
Denise Coal Co., 29 T.C. 528 35
Dragon Cement Company v. *United States*, 244 F. 2d 513, certiorari denied, 355 U.S. 833 14
Duparquet Co. v. *Evans*, 297 U.S. 216 49
Nathan Fink, 29 T.C. 1119 .....36, 38, 40, 53
Guy v. *Donald*, 203 U.S. 399 56
Hamill Coal Corp., 23 T.C. 1120, reversed, 239 F. 2d 347 36
Helvering v. *Bankline Oil Co.*, 303 U.S. 362 ....9, 13, 18, 20, 21, 28, 32, 43, 44
Helvering v. *Elbe Oil Land Co.*, 303 U.S. 372 26
Helvering v. *O'Donnell*, 303 U.S. 370 26
Helvering v. *Twin Bell Syndicate*, 293 U.S. 312 22
Helvering v. *Winmill*, 305 U.S. 79 44
Huss v. *Smith*, No. 305, this Term 2, 33, 41, 42
Hyde v. *United States*, 225 U.S. 347 56
Kirby Petroleum Co. v. *Commissioner*, 326 U.S. 599.. 26
Kohinoor Coal Co. v. *Commissioner of Internal Revenue*, 171 F. 2d 880, certiorari denied, 337 U.S. 924 14
Lowden v. *Northwestern National Bank*, 298 U.S. 160 56
Mammoth Coal Co., 22 T.C. 571, reversed, 229 F. 2d 535 36
Matagorda Shell Co., 29 T.C. 1060 .....26, 38
Walter Bernard McCall, 27 T.C. 133 .....39, 41
Morrisdale Coal Mining Co., 19 T.C. 208 38
Palmer v. *Bender*, 287 U.S. 551.....9, 13, 17, 28, 37, 43
Panama Refining Co. v. *Ryan*, 293 U.S. 388 49
James Ruston, 19 T.C. 284 .....35, 39, 41, 54
Stilwell v. *United States*, 250 F. 2d 736..2, 3, 4, 7, 8, 13, 32, 38, 40, 53, 54
Stilwell v. *United States*, 152 F. Supp. 111 ..... 7, 8
Thomas v. *Perkins*, 301 U.S. 655 .....10, 37, 39
Turkey Run Fuels v. *United States*, 243 F. 2d 147 ... 14
United States v. *Aluminum Co. of America*, 148 F. 2d 416 54
United States v. *Dakota-Montana Oil Co.*, 288 U.S. 459 22
United States v. *Ludey*, 274 U.S. 295..9, 13, 15, 16, 21, 43
United States v. *McKesson & Robbins*, 351 U.S. 305 22

Page

United States v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708, certiorari denied, 355 U.S. 824 14
United States v. *Wrightwood Dairy Co.*, 315 U.S. 110 22
Usibelli v. *Commissioner of Internal Revenue*, 229 F. 2d 539 .....29, 31, 40
J. E. Vincent, 19 T.C. 501, reversed, 212 F. 2d 52 ... 36
Virginia B. Coal Co., 25 T.C. 899 .....35, 39
Weirton Ice & Coal Sup. Co. v. *Commissioner of Int. Rev.*, 231 F. 2d 531 .....30, 36, 40, 43
Weirton Ice & Coal Sup. Co., 24 T.C. 374, reversed, 231 F. 2d 531 36

STATUTES:

Internal Revenue Code of 1939:

Sec. 23(a) 34
Sec. 23(l) 34
Sec. 23(m) 9, 12, 17, 22, 47, 48, 49, 51, 53
Sec. 111 35
Sec. 112 35
Sec. 114 22
Sec. 114(b)(3) 23, 52
Sec. 114(b)(4) 52
Sec. 114(b)(4)(A) 50
Sec. 114(b)(4)(A)(ii) 49
Sec. 117 35
Sec. 117(k)(1) 50, 51
Sec. 117(k)(2) 12, 48, 50, 51, 53
Sec. 122 35

Internal Revenue Code of 1954:

Sec. 162(a) 34
Sec. 167 34
Sec. 172 35
Sec. 611(b)(1) 17
Sec. 613(a) 50
Sec. 613(b)(1) 23
Sec. 614(a) 37
Sec. 631(a) 37
Sec. 631(b) 51, 52
Sec. 631(c) 48, 51, 52
Sec. 1001 35

Page

Sec. 1002 35
Sec. 1211 35
Sec. 1212 35
Sec. 1231 35

Revenue Act of 1913:
Sec. II B [Deductions] 16

Revenue Act of 1918:
Sec. 211(b) 23
Sec. 214(a)(10) 16, 23

Revenue Act of 1921:
Sec. 214(a)(10) 16

Revenue Act of 1924:
Sec. 214(a)(9) 16

Revenue Act of 1926:
Sec. 204(c)(2) 23
Sec. 214(a)(9) 16

Revenue Act of 1928:
Sec. 23(l) 16
Sec. 114(b)(3) 23

Revenue Act of 1932:
Sec. 23(l) 16
Sec. 114(b)(3) 23

Revenue Act of 1934:
Sec. 23(m) 17
Sec. 114(b)(3) 23

Revenue Act of 1936:
Sec. 23(m) 17
Sec. 114(b)(3) 23

Revenue Act of 1938:
Sec. 23(m) 17
Sec. 114(b)(3) 23

Revenue Act of 1951:
Sec. 319(a) 49
Sec. 325(b) 47

Page

TREASURY REGULATIONS AND RULINGS:

Cum. Bull.:
1950-1, p. 42 ..... 12, 45
1944, p. 124 20
1953-2, p. 169 20

General Counsel's Memoranda (GCM):
No. 26290 ..... 12, 45

Proposed Regulations under 1954 I.R.C.,
Sec. 1.611.1(b)(1) 21

Treasury Decisions (T.D.):
No. 5413 20
No. 6021 20

Treas. Reg. 101:
Art. 23(m)-1 20

Treas. Reg. 103:
Sec. 19.23(m)-1 ..... 12, 20
Sec. 19.23(m)-1(i) 37

Treas. Reg. 111:
Sec. 29.23(m)-1 ..... 12, 20
Sec. 29.23(m)-1(i) 10, 37, 44

Treas. Reg. 118:
Sec. 39.23(m)-1(a) and (b) 12, 20
Sec. 39.23(m) 1(i) 37

MISCELLANEOUS:

Baker and Griswold, *Percentage Depletion—A Correspondence*, 64 Harv. L. Rev. 361 23
Bituminous Coal and Lignite in 1957 ..... 5, 7
J. Sup. Ct.:
Oct. T. 1945, pp. 195, 196, 199 27
Oct. T. 1958, p. 13 2
H. R. Rep. 1, 69th Cong., 1st sess., p. 6 23
H. R. Rep. 305, 69th Cong., 1st sess., pp. 31-32 23
H. R. Rep. 586, 82d Cong., 1st sess., pp. 31-32 49
Mineral Facts and Problems 5, 7
Mineral Yearbook—Fuels (H. R. Doc. 23, 84th Cong., 1st sess., Vol. II) 5, 7

Page

National Coal Ass'n., *Bituminous Coal Facts 1958*.. 5, 7
Sen. Rep. 617, 65th Cong., 3d sess., p. 6 .....22, 24
Sen. Rep. 52, 69th Cong., 1st sess., pp. 17-18 23
Sen. Rep. 781, 82d Cong., 1st sess., pp. 4243 49
Sen. Rep. 781, 82d Cong., 1st sess., Part. 2, pp. 43-45 49
Sherman & MacMurphy, *Facts About Coal* 5, 7
Treusch, *Litigation Policy of the Chief Counsel's Office in Civil Tax Cases*, 36 Taxes 958 3

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, ET AL., *Petitioners,*

v.

FRANCIS R. SMITH, Former Collector of Internal Revenue for the First District of Pennsylvania

---

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

BRIEF OF PARAGON JEWEL COAL COMPANY, INC., AS AMICUS CURIAE

Pursuant to Rule 42(2) and the written consent of the parties hereto, Paragon Jewel Coal Company, Inc., files this brief as *amicus curiae.*

INTEREST OF AMICUS CURIAE

The present case involves the question whether a contractor engaged in mining coal is entitled to a percentage depletion allowance, and, as the Solicitor General pointed out when the petition for certiorari was pending here (Resp. Memo. 3-4), "to the extent that the strip miner is allowed a depletion deduction, there

must be a corresponding disallowance of the deduction to the owner of the property.'"[1]

Paragon Jewel Coal Company, Inc., a Virginia corporation, is the lessee of coal lands in the Commonwealth of Virginia. It does not mine coal itself, but makes contracts with other corporations and individuals for the actual mining. The extent and details of its operations are set forth below, pp. 4-9.

In *Stilwell* v. *United States*, 250 F. 2d 736 (C. A. 4), certain parties who had contracts with *amicus curiae* (hereinafter called simply Paragon Jewel) to mine coal were granted the right to a depletion allowance, with the result that the depletion allowance available to Paragon Jewel stands to be correspondingly diminished. The result in that case operated to the disadvantage of Paragon Jewel, which, in substance and effect, lost the case; but since it was not a party thereto, it was not able to seek review, and it now faces uncertainty as to its tax liability for that and future years.

The Third Circuit in the case at bar specifically refused to follow the *Stilwell* decision. R. 37-38; see also the companion case, *Huss* v. *Smith*, No. 305, at R. 82 (sur petition for rehearing).

Paragon Jewel has accordingly a substantial interest in establishing that the Third Circuit has correctly

---

[1] Respondent's Memorandum, just cited, applied also to No. 305, *Huss* v. *Smith*, now pending on writ of certiorari and consolidated for hearing with the present case. See J. Sup. Ct., Oct. T. 1958, p. 13. The Solicitor General's consent to the filing of the present brief extended also to No. 305. Consent to filing was similarly requested of counsel of record for the petitioners in No. 305, who however did not respond to communications sent him, and in that sense did not consent.

construed the statute in the present cases, and that the Fourth Circuit fell into error in the *Stilwell* case in allowing to the contractor of Paragon Jewel any share of the depletion allowance.

Contrariwise, it is apparent from the Solicitor General's Memorandum heretofore filed herein that the Government is simply a stakeholder. He said (Resp. Memo. 3-4):

> "2. It is important in the administration of the revenue laws that the issue presented be finally resolved. The depletion allowance is one that must be 'equitably apportioned between the lessor and lessee' of mineral property. Section 23(m) of the Internal Revenue Code of 1939. Percentage depletion is allowed, under Section 114(b) of the Code, on the 'gross income from the property' and, to the extent that the strip miner is allowed a depletion deduction, there must be a corresponding disallowance of the deduction to the owner of the property. See *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 309. Thus, uncertainty as to whether a strip mining contractor is entitled to the deduction makes administration of the law in this respect difficult."

The same view is reflected in a recent paper by an official closely concerned with tax litigation at lower levels: "To the government generally it is a matter of comparative indifference which side bears the burden of the tax, just so the matter is settled and the government is not whipsawed." Treusch, *Litigation Policy of the Chief Counsel's Office in Civil Tax Cases*, 36 Taxes 958, 969. The quoted comment was made with specific reference to the coal depletion problem, including the present case, and to the inconsistent Government positions reflected in *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 309, note 1.

Such inconsistency is inevitable, inasmuch as the Government is bound to resist the attempt of each taxpayer concerned to establish his right either to any depletion allowance whatever or else to a larger portion of such allowance. This condition is amply demonstrated in the cases discussed below, pp. 27-33. But where, as in all of the cases—this one as well as the others—there is a percentage depletion allowance to be divided between different taxpayers, the Government's interest in the suit of either one is only nominal, and the true adverse party remains unrepresented in a litigation which vitally affects its own tax liability.

The quoted excerpts indicate that the Government is concerned only that there be a consistent rule to facilitate the administration of its tax laws. Paragon Jewel, on the other hand, is deeply concerned with the substance of the rule to be formulated. Consequently it files this brief *amicus curiae*, not simply on the all too common basis of "me too" or of "anything-you-say-we-can-say-better," but in order that the views of the interest genuinely adverse to that of the present petitioners may be before the Court.

As will be seen, Paragon Jewel supports the decision below on the view that the result contended for by petitioners here, which was reached by the Fourth Circuit in *Stilwell* to the detriment of *amicus curiae*, involves an egregious misreading of the statute.

OPERATIONS AND BUSINESS OF AMICUS CURIAE

Amicus curiae, Paragon Jewel Coal Company, Inc., is a small Virginia corporation, with an authorized capital stock of $100,000, of which only $37,500 has been issued. Its principal place of business is at Bluefield, West Virginia, but its properties are in

Virginia, where it is lessee of some 4932 acres of bituminous coal land under eight separate leases.

Its average annual coal production for the years 1953 to 1957 inclusive was 417,158 tons, or about one tenth of one percent of the average national production.[2]

In areas where bituminous coal is found in thick seams, of from 50 inches to 10 or 12 feet, underground mining has become an increasingly mechanized operation, so that in 1957 some 80% of all underground coal was cut by machines. Where the thick seams are reasonably close to the surface, mining is done by stripping; i.e., large shovels and draglines strip off the earth and expose and then mine the coal. Today some 25% of all bituminous coal is mined by stripping. Petitioners in this and the companion cases are strippers.[3]

The seams in the coal properties leased by Paragon Jewel are only about 27 to 28 inches thick. Such shallow seams are known as "low coal"; they are not capable of being mined by mechanization, as no automatic machinery can cut or load low coal. The coal is therefore extracted by the process of "drift mining," which consists of "facing" the side of the coal-bearing hill—

---

[2] The total national bituminous coal production for the same period averaged 460,900,600 tons per year. See National Coal Association, *Bituminous Coal Facts 1958*, p. 55, based on U. S. Bureau of Mines figures.

[3] Present day bituminous coal production trends and figures are discussed in *Minerals Yearbook—Fuels* (H. R. Doc. 23, 84th Cong., 1st sess.), Vol. II, pp. 30-93; Sherman & MacMurphy, *Facts About Coal* (U. S. Dept. Int., Bu. Mines, 1955 ed.) 11-21; *Mineral Facts and Problems* (U. S. Bu. Mines Bull. 556, 1956) 121-124; *Bituminous Coal Facts 1958*, *supra* note 2, 13-18; *Bituminous Coal and Lignite in 1957* (Bu. Mines Mineral Market Summary No. 2830, Sept. 26, 1958) 28-68.

i.e., removing the earth to expose the coal seam—and then mining directly into the hill, cutting away the coal as it is reached by a horizontal opening. (In mining terminology, a "drift" is a horizontal tunnel made into the side of a hill, as distinguished from a "shaft," which is a vertical opening straight down into the earth.)

Drift mining is essentially a marginal operation, and therefore Paragon Jewel, like most other lessees similarly situated, employs independent contractors to do the actual mining. This relieves Paragon Jewel of the expenses of providing equipment and maintaining an elaborate organization. In many instances, shallow thin-seamed drift mines are worked by miners who suffered technological unemployment in consequence of the widespread mechanization of thick-seamed mines.

As has been indicated, Paragon Jewel is not the owner of the land in fee, but simply a lessee of the coal. The operative portions of a typical Paragon Jewel lease now in force are set forth in Appendix A, *infra,* pp. 1a-8a. Under that lease, Paragon Jewel pays a minimum mining royalty, payable whether or not any mining is done; and it pays all real estate taxes imposed by Virginia law.

Prior to making contracts for mining the coal, Paragon Jewel built roads, power lines, and railroad sidings, and, most important of all, it constructed a tipple. Its capital outlay for these items came to about $725,000. All coal mined by its contractors is brought to the tipple, where it is cleaned, washed, and graded as to size. This operation is an indispensable prerequisite to marketing the product, inasmuch as uncleaned and ungraded mine-run coal, in

the condition in which it is delivered to the tipple, is not commercially saleable.[4]

Paragon Jewel's relations with its contractors are now formalized by a written contract on a standard form; a copy is provided in Appendix B, *infra* pp. 9a-13a.

Under the terms of that contract, Paragon Jewel faces up the seam for entry by the contractor, and Paragon Jewel directs the contractor where it is to mine. The contractor is compensated by being paid a fixed price for every ton of coal delivered to Paragon Jewel at its tipple. This price is set forth in the contract, and is not subject to change retroactively. The contract provides for prospective changes in compensation on "at least three days' notice," so that such changes will apply only to unmined coal. Thus it is Paragon Jewel and not the contractor who bears the risk of the market. Finally, the contract is terminable at the will of either party on written notice.

It is proper to point out that, while all but two of Paragon Jewel's 32 contractors have now signed this written agreement, which simply formalized prior oral arrangements, the occasion for the written contract was the disregard by the Fourth Circuit in *Stilwell* v. *United States*, 250 F. 2d 736, of the specific findings of fact made below, *Stilwell* v. *United States*, 152 F. Supp. 111 (W. D. Va.). This appears from the following extracts:

---

[4] See, as to the importance of cleaning coal, the following references in the works already cited: *Minerals Yearbook—Fuels*, 93-113; Sherman & MacMurphy, *Facts about Coal*, 21-22; *Mineral Facts and Problems*, 124-125; *Bituminous Coal Facts 1958*, 17-18; *Bituminous Coal and Lignite in 1957*, 69-80.

(A) *Finding 14, 152 F. Supp. at 113*

"14. The contract entered into between plaintiffs and Paragon was terminable at the will of either party."

(A) *C.A. 4 opinion, 250 F. 2d at 739*

"The contract was not terminable by Paragon as long as taxpayers' operations were satisfactory and the coal could be profitably marketed. • • • This is not a case where the contract is clearly terminable at the will of either party • • •."

(B) *Finding 16, 152 F. Supp. at 113*

"16. Plaintiffs completed their obligation under the contract by delivering the coal to Paragon's tipple and thereupon became entitled to their compensation for mining the coal by virtue of Paragon's personal covenant to pay for such services at the amount per ton previously agreed upon by the contracting parties. Plaintiffs were not concerned with the sale price Paragon received for the coal."

(B) *C.A. 4 Opinion, 250 F. 2d at 739*

"This is not a case • • • where the contractor's income is dependent upon the personal covenant of those with whom he has contracted without regard to the price at which the coal is sold."

It is also proper to point out that drift mining differs in some respects from the strip mining that is directly involved in the present case. The strip miner normally builds his own roads, he must find the coal in a general area assigned to him, he must furnish his own power, and he has a larger investment, because his machinery is larger and hence more expensive. The drift miners under contract with Paragon Jewel do not build any roads, mine only as and where directed by Paragon Jewel, do not normally supply power lines, and have a very much smaller capital investment in machinery.

Under our views of the governing law, views fully set forth in the course of the argument, these

differences do not add up to a legal distinction and indeed are quite irrelevant.

SUMMARY OF ARGUMENT

I. "In essence, the deduction for depletion does not differ from the deduction for depreciation" (*United States* v. *Ludey,* 274 U. S. 295, 303, *per* Brandeis, J.), the purpose of both being to compensate the owner of a capital asset that is used up in the course of producing income.

In the case of leases, the depletion allowance is required to be equitably apportioned between lessor and lessee (§ 23(m), I.R.C. 1939, and cognate provisions from 1918 through 1954), and where a rigid application of conventional common law estates might work injustice, depletion is allowed to any taxpayer who acquired, through a capital investment on his part, an economic interest in the mineral in place. *Palmer* v. *Bender,* 287 U. S. 551. But the depletion allowance is not available to one who has no capital investment in the mineral in place, but simply has, through contract, an economic advantage from production of that mineral. *Helvering* v. *Bankline Oil Co.,* 303 U. S. 362, *per* Hughes, C. J. That differentation, between economic interest acquired by capital investment and mere economic advantage obtained by contract, was written literally into the Treasury Regulations in 1939, and has been there ever since; the version applicable in the present case is Treas. Reg. 111, § 29.23(m)-1.

No authoritative materials support the contention that the purpose of the depletion allowance (as distinguished from its amount in particular instances) was to encourage development of mineral resources by

compensating prospectors for their risk. In any event, contractors engaged in stripping or drift-mining of coal assume no appreciable risk; they work known coal fields. And the present petitioners had other activities to which their machinery was adapted, and indeed insisted that their coal mining contract be terminable in order that they might be free to revert to their other pursuits.

II. Later oil and gas cases in this Court have blurred the distinction originally laid down, see *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 313-314, and thereafter the lower courts, particularly the Fourth Circuit, have concentrated on the words "economic interest" to the exclusion of the necessary qualification "which represented their capital investment." The Fourth Circuit has accordingly in a series of cases granted a share of the depletion allowance to taxpayers who simply contracted with the owner of the fee or with the lessee of the coal lands, in situations where the taxpayer had no capital investment whatever in the minerals in place. This result, which petitioners urge in the present case, distorts the statute and perverts the purpose of the depletion allowance.

III. A. Petitioners are not entitled to a depletion allowance because they have neither made nor acquired any capital investment in the coal in place. Their capital investment in machinery is recoverable through the depreciation allowance, so that to give them in addition a share in the depletion allowance would be a purely gratuitous benefit neither intended nor warranted by the statute. Ownership of the mineral deposit is essential to a right to deduct for depletion. *Thomas* v. *Perkins*, 301 U. S. 655, 661. Treas. Reg.

111, § 29.23(m)-1(i), applicable here, speaks of "the interest owned by the taxpayer in any mining property." Petitioners cannot point to any interest that they owned in the tracts they were mining.

B. Their lack of ownership of the coal in place is emphasized by the fact that they received a fixed price for mining the coal, which was not subject to market fluctuations. This circumstance is, and has been held to be, virtually conclusive against a contractor's claim to depletion. But where the contractor has no capital investment in the coal in place, he should not be entitled to a deduction for percentage depletion regardless of how his compensation is fixed.

C. Petitioners are not entitled to share in the depletion allowance because their contracts were terminable at the will of the owner of the coal lands. This circumstance, also, has been held to constitute a well-nigh conclusive bar to allowing the contractor any depletion deduction. The true rationale, it is submitted, is that a contract terminable without compensation at another's whim utterly negatives the notion that the contractor invested capital on those terms.

D. Petitioners' contract here was non-exclusive, but even under an exclusive contract they would not be entitled to depletion. Two contractors cannot mine the same area simultaneously, and if one mines after the other, the same considerations apply as those already mentioned under terminability.

E. The fact that there may be a right under the contract to mine a particular tract to exhaustion is immaterial. Most contracts for the completion of a particular job necessarily contemplate that the work

will eventually come to an end, but that fact does not give the contractor a depletion allowance for the progressive diminution of the value of his contract.

F. If the rule that weight is to be given long-continued administrative interpretations has any force at all, then the Treasury's consistent stand against the depletion deduction to contractors in petitioners' position bars them here. Treas. Reg. 103, § 19.23(m)-1; Treas. Reg. 111, § 29.23(m)-1; Treas. Reg. 118, § 39.23(m)-1(a) and (b); GCM 26290, Cum. Bull. 1950-1, p. 42.

IV. The legislation which since 1951 has permitted the lessor of coal lands to capitalize his royalty income as a substitute for a share of the percentage depletion allowance constitutes an additional reason why a mere contractor is not entitled to any portion of such allowance.

In 1951, Congress amended § 117(k)(2) of the Internal Revenue Code of 1939, and thereby gave the lessor of coal lands — but not of oil or gas lands — capital gains treatment for his royalties in lieu of the equitable apportionment of the depletion allowance theretofore his under § 23(m). Since 1951, therefore, the lessee of coal lands is entitled to an indivisible depletion allowance. The contractor is plainly not a lessor, nor can he be considered a lessee. And other portions of the 1951 amendments show that Congress did not intend to confer on the taxpayer who only held a contract to mine the coal any right to share in the allowance for percentage depletion.

The foregoing conclusions, drawn from the 1951 amendments, are confirmed even more strongly by the clarifying revisions made in the 1954 Code.

The 1951 legislation appears to have been completely overlooked in all cases to which it would be applicable by its terms. The committee reports do not mention the present problem, which up to then had never been decided in favor of the contractor in reported litigation. But the 1951 amendment throws a revealing cross light on the statute, emphasizing the unsoundness of the lower courts' concentration on "economic interest" in disregard of the necessary qualification that such interest must represent an investment in the coal in place. Accordingly, the 1951 amendments (and, *a fortiori*, the 1954 revision) underscores the basis of the original decisions here on the rationale of the depletion allowance (*United States* v. *Ludey*, 274 U. S. 295; *Palmer* v. *Bender*, 287 U. S. 551; *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362), decisions whose underlying principle is conclusive against the present petitioners and against any other taxpayers who, similarly, simply contract to mine coal for others.

ARGUMENT

Paragon Jewel's position is that the decision below in the present case is clearly right, and that the contrary result reached by the Fourth Circuit, which allowed percentage depletion to one of Paragon Jewel's independent contractors who had no capital investment in the coal deposits being mined, is clearly wrong. *Stilwell* v. *United States*, 250 F. 2d 736; see also other Fourth Circuit cases discussed at length below, pp. 27-28, 30-33.

The Fourth Circuit rulings are erroneous, basically because they ignore the purpose of the depletion deduction, and because they have accordingly con-

centrated on the concept of "economic interest"—which was a wholly non-statutory expression prior to 1951—applying it as though it were a slogan while ignoring its essential qualification, namely, that it must be an economic interest in the wasting mineral asset which represents a capital investment.

The resultant misapplication of the statute operates to the disadvantage of Paragon Jewel, a coal lessee with a substantial investment in the coal in place, and of others with either leasehold or fee interests in coal lands, who similarly make contracts with outsiders for the extraction of their coal.

In the present confused state of the case law, Paragon Jewel believes that a reexamination of the fundamental principles underlying the percentage depletion provisions of the Internal Revenue Code will prove helpful to the Court.[1]

---

[1] Neither this case nor its companion involve, nor do we discuss, the many related depletion problems that are met with in the books. E.g., are coal lands containing materials already extracted from a coal mine subject to a further depletion allowance? Compare *Kohinoor Coal Co.* v. *Commissioner of Internal Revenue*, 171 F. 2d 880 (C.A. 3), certiorari denied, 337 U. S. 924, with *Turkey Run Fuels* v. *United States*, 243 F. 2d 147 (C.A. 3). E.g., is the dollar base for computing the percentage depletion the cost of the mineral deposit in its natural state (e.g., clay), or the cost of the ultimate product after manufacturing (e.g., bricks)? See *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5), certiorari denied, 355 U. S. 824; see also *Dragon Cement Company* v. *United States*, 244 F. 2d 513, certiorari denied, 355 U. S. 833. E.g., what are "ordinary 'treatment processes'" for purposes of computing the amount of the percentage depletion? See *Commissioner of Int. Rev.* v. *American Gilsonite Co.*, 259 F. 2d 654 (C.A. 10).

I. THE DEPLETION ALLOWANCE IS A FORM OF DEPRECIATION ALLOWANCE, AND IS AVAILABLE ONLY TO THOSE WHO HAVE AN ECONOMIC INTEREST, ACQUIRED BY INVESTMENT, IN THE WASTING CAPITAL ASSET OF MINERALS IN PLACE.

Some thirty years ago, Mr. Justice Brandeis with his customary lucidity explained the rationale of the depletion allowance granted by the internal revenue laws to owners of mineral deposits. *United States* v. *Ludey*, 274 U. S. 295. He said (274 U. S. at 302):

> "The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured. It must be approximated. And because the quantity originally in the reserve is not actually known, the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge, is necessarily a rough estimate. But Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion."

And he added (274 U. S. at 303), "In essence, the deduction for depletion does not differ from the deduction for depreciation."

In this connection, it is significant that, in the first income tax act following adoption of the Sixteenth Amendment, Congress lumped depreciation and depletion under a single heading.[2]

The last sentence quoted from the *Ludey* opinion deserves special emphasis as applied to the case of strip or drift mining: The owner of the coal deposits, who has invested in the coal, receives an allowance for depletion of that capital asset; the contractor, who has invested in mining machinery, receives an allowance for depreciation of his machinery—which is his capital asset. The contractor in such a situation should not receive a depletion allowance as well. Yet that is what petitioners are seeking here.

Beginning with the Revenue Act of 1918 and continuously thereafter, the depletion allowance provisions of the Internal Revenue Acts have provided, with hardly any change in phraseology, that "In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee."[3]

---

[2] Sec. II B [Deductions] of the Act of Oct. 3, 1913, c. 16, 38 Stat. 114, 167: "* * * sixth, a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year in which the computation is made * * *."

[3] Sec. 214(a)(10) of the Revenue Act of 1918; § 214(a)(10), Revenue Act of 1921; § 214(a)(9), Revenue Act of 1924; § 214(a)(9), Revenue Act of 1926.

In 1928, the sentence was changed to read, "In the case of leases the deduction shall be equitably apportioned between the lessor and lessee." § 23(1), Revenue Act of 1928.

With the single change of "deductions" for "deduction", the revised phraseology was repeated in § 23(1), Revenue Act of

In the case of oil wells, it soon became apparent that a rigid application of conventional common law estates might work an injustice, and in *Palmer* v. *Bender*, 287 U. S. 551, it was held that where the owner of an oil or gas lease transferred his lease to another in consideration of a bonus and royalties, the bonus so received was a return *pro tanto* of the transferor's capital investment in the oil, entitling such transferror to a depletion allowance.

The Court, *per* Stone, J., said (287 U. S. at 558):

> "In the present case the two partnerships acquired, by the leases to them, complete legal control of the oil in place. Even though legal ownership of it, in a technical sense, remained in their lessor, they, as lessees, nevertheless acquired an economic interest in it which represented their capital investment and was subject to depletion under the statute. *Lynch* v. *Alworth-Stephens Co.*, [267 U. S. 364] *supra*. When the two lessees transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, an economic interest in the oil, in place, identical with that of a lessor. *Burnet* v. *Harmel* [287 U. S. 103], *supra; Bankers Pocahontas Coal Co.* v. *Burnet* [287 U. S. 308], *supra*. Thus, throughout their changing relationships with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom, the original lessors, the two partner-

---

1932; § 23(m) of the Revenue Acts of 1934, 1936, and 1938; and in § 23(m) of the Internal Revenue Code of 1939.

In 1954, the substance of the foregoing was again repeated in § 611(b)(1), I.R.C. 1954, in these terms: "(1) **Leases.**—In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and the lessee."

> ships and their transferees, were entitled to share in the oil produced. Production and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests. The loss or destruction of the oil at any time from the date of the leases until complete extraction would have resulted in loss to the partnerships. Such an interest is, we think, included within the meaning and purpose of the statute permitting deduction in the case of oil and gas wells of a reasonable allowance for depletion according to the peculiar conditions in each case."

It is to be noted that the foregoing rationale depends on "an economic interest in the oil, in place," representing a "capital investment." We stress the qualifications, because, as will be seen, petitioners here and the Fourth Circuit in the cases discussed below (pp. 27-28, 30-33), have ignored it and have concentrated on the words "economic interest" to the exclusion of all else.

A few years later, the Court reviewed the cases, emphasizing that the depletion allowance was not available to one who had no capital investment in the mineral deposit. *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362. Chief Justice Hughes said (303 U. S. at 366-367):

> "In order to determine whether respondent is entitled to depletion with respect to the production in question, we must recur to the fundamental purpose of the statutory allowance. The deduction is permitted as an act of grace. It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production. *United States* v. *Ludey*, 274 U. S. 295, 302. The granting of an

arbitrary deduction, in the case of oil and gas wells, of a percentage of gross income was in the interest of convenience and in no way altered the fundamental theory of the allowance. *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 467. The percentage is 'of the gross income from the property,'—a phrase which 'points only to the gross income from oil and gas.' *Helvering* v. *Twin Bell Syndicate*, 293 U. S. 312, 321. The allowance is to the recipients of this gross income by reason of their capital investment in the oil or gas in place. *Palmer* v. *Bender*, 287 U. S. 551, 557.

"It is true that the right to the depletion allowance does not depend upon any 'particular form of legal interest in the mineral content of the land'. We have said, with reference to oil wells, that it is enough if one 'has an economic interest in the oil, in place, which is depleted by production'; that 'the language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.' *Palmer* v. *Bender*, *supra*. But the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit. See *Thomas* v. *Perkins*, 301 U. S. 655, 661."

And he added (303 U. S. at 368):

"Undoubtedly, respondent through its contracts obtained an economic advantage from the production of the gas, but that is not sufficient. The controlling fact is that respondent had no interest in the gas in place. Respondent had no capital

> investment in the mineral deposit which suffered depletion and is not entitled to the statutory allowance."

The *Bankline Oil* case was decided in March 1938. The differentiation made therein; between economic interest acquired by capital investment and mere economic advantage obtained by contract, was not reflected in the regulations that were promulgated on July 15, 1938, to implement the Revenue Act of 1938 (see Treas. Reg. 101, Art. 23(m)-1), but it was written almost literally into the first regulations under the Internal Revenue Code of 1939 (see Treas. Reg. 103, § 19.23(m)-1, dated August 23, 1939). There have been minor changes in the economic-interest vs. economic-advantage paragraph, which are duly noted in the margin;[4] we do not consider them significant in the resolution of the basic issue presented by the present case. For the years 1942 to 1951 inclusive, which cover the taxes involved in the case at bar, the regulation in force was Treas. Reg. 111, § 29.23(m)-1, which read in pertinent part as follows:

> "* * * An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal

---

[4] Treas. Reg. 103, § 19.23(m)-1, was applicable to tax years beginning after Dec. 31, 1938. It was not amended in any respect presently pertinent.

Treas. Reg. 111, § 29.23(m)-1, was applicable to tax years beginning after Dec. 31, 1941. There have been two amendments here pertinent: (a) T.D. 5413, Cum. Bull. 1944, p. 124; (b) T.D. 6021, Cum. Bull. 1953-2, p. 169.

The regulation applicable to years beginning after Dec. 31, 1951, is Treas. Reg. 118, § 39.23(m)-1(a) and (b). It has not been amended in any respect now pertinent.

relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.'"[5]

It is significant that petitioners' discussion fails utterly to cite the *Ludey* case, and that it deals with the *Bankline Oil* decision only in a footnote, from which discussion of the underlying rationale of Chief Justice Hughes' opinion appears to be studiously omitted (Pet. Br. 10, note 9). We submit that the obstacles which these basic decisions place in the way of petitioners' claims do not disappear simply because it may seem convenient to ignore them.

As we will show, the concepts that were formulated in the shaping decisions set forth above became somewhat blurred in later cases in this Court, and the basic factor stressed in the decisions just discussed—that to be entitled to a depletion allowance, the taxpayer must have made a capital investment in the wasting mineral asset, so that his income represented a using up of capital, for which the allowance compensated

[5] Sec. 1.611-1(b)(1) of the proposed regulations under I.R.C., 1954, differs somewhat, but that provision has not yet been promulgated, and its ultimate form may well depend on the outcome of the present litigation.

him—that factor of capital investment was slurred over. And, in the Fourth Circuit decisions that we are about to discuss, this vital qualification was ignored, only the slogan of "economic interest" was emphasized, and accordingly the independent mining contractor, whose investment in machinery was returned to him through a depreciation allowance, received—by plain perversion of the purpose of the statute—a percentage depletion allowance in addition, based on the wasting of a mineral asset that constituted no investment on his part.[6]

Petitioners' argument (Pet. 13-15) that the purpose of the depletion allowance was to stimulate the development of natural resources and to compensate the prospector for the risks inherent in his activities will not survive examination, for a number of reasons.

First of all, the legislative materials quoted are simply individual expressions, and hence are plainly not authoritative as to the purpose or meaning of the statute. E.g., *United States* v. *McKesson & Robbins*, 351 U. S. 305, 313-315; *United States* v. *Wrightwood Dairy Co.*, 315 U. S. 110, 125. Significantly enough, nothing is quoted from the committee reports cited; those do not help petitioners, and indeed are distinctly out of context in the present connection.[7]

---

[6] We discuss only the right, if any, to the percentage depletion allowance granted by §§ 23(m) and 114, I.R.C. 1939. The statutory development of the depletion allowance, which culminated in the present percentage depletion method, is set forth in *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 460-461, and in *Helvering* v. *Twin Bell Syndicate*, 293 U.S. 312, 315-318.

[7] (a) Sen. Rep. 617, 65th Cong., 3d sess., p. 6 [cited Pet. Br. 13, note 11; Pet. Br., No. 305, at pp. 15-16; Br. *A. C.* of Estate of John Schumacher, 5], deals primarily with a lower surtax for the

Next, most of the arguments that emphasize the risk factor have been adduced, not to justify the basic purpose of the depletion allowance—the reason for which has been clearly and convincingly set forth in this Court's decisions, already discussed — but to justify the amount of percentage depletion for oil and gas, which ever since 1926 has been fixed at 27½ per cent of gross income per annum.[8]

The merits of the respective arguments on that question are for Congress, and for Congress alone. Cf. Baker and Griswold, *Percentage Depletion — A Correspondence,* 64 Harv. L. Rev. 361. The point here is that there are no competent legislative materials that modify in any way the rationale of the depletion allowance laid down by this Court from 274 U. S. through 303 U. S., *supra.*

Third, even to the extent that compensation for risk may be a factor, it is simply not possible to equate the situation of a coal stripper, engaged by contract

---

ultimately successful prospector, see § 211(b) of the Revenue Act of 1918; and for an increased depletion allowance to meet his situation, § 214(a)(10).

(b) H.R. Rep. 1, 69th Cong., 1st sess., p. 6 [cited Pet. Br. 13, note 11; Pet. Br., No. 305, 16] discusses only "Discovery Value" in connection with discovery depletion. The Senate amended the bill to introduce the percentage depletion method (Sen. Rep. 52, 69th Cong., 1st sess., pp. 17-18), and the House then concurred in substance (H.R. Rep. 356, 69th Cong., 1st sess., pp. 31-32 (Amendment 6)).

Plainly, neither reference has any bearing on the basic purpose of the depletion allowance.

[8] Sec. 204(c)(2), Revenue Act of 1926; Sec. 114(b)(3) of the Revenue Acts of 1928, 1932, 1934, 1936, and 1938, and of I.R.C. 1939; Sec. 613(b)(1), I.R.C. 1954.

See, in support of the statement in the text, the committee reports cited in the preceding note.

to remove the overburden from known coal lands, with that of the prospector for oil and gas, who "frequently expends many years and much money in fruitless search." Sen. Rep. 617, 65th Cong., 3d sess., p. 6. It is utterly unrealistic to suggest that the coal stripper assumes risk that is different in any degree from the risk inherent in any contracting job.

And, finally, as the opinion of the court below plainly shows, these petitioners were not exclusively engaged in coal-stripping. Their firm (R. 35) "is a contractor and over the years has engaged in road building, strip mining and the drilling of gas wells." Moreover (R. 38-39), "There has been no showing that [petitioners'] equipment was specially adapted to this job or that it would not be suitable thereafter for such other undertakings as constituted the normal and familiar business of this contractor." And, what perhaps climaxes the situation (R. 35), "Parsons * * * did not wish to be bound to a long term performance because, if opportunity should arise, it wished to return to road building."

It is simply fantastic, on the facts reflected in this record, to urge that petitioners are to be assimilated, for any purpose, to the patient prospector or the hopeful wildcatter who, after years and years of unproductive effort, finally strikes it rich.

In any event, formative cases here on depletion lend no support whatever to either the risk or the encouraging-of-prospecting rationalizations now advanced.

II. THE ESSENTIAL PREREQUISITE TO THE RIGHT TO DEDUCT FOR DEPLETION—AN ECONOMIC INTEREST IN THE MINERALS IN PLACE REPRESENTING A CAPITAL INVESTMENT—HAS BEEN DISTORTED BY THE FOURTH CIRCUIT TO THE POINT OF ABANDONMENT.

In recent cases here, efforts to distinguish between interests entitled to a depletion allowance for oil and gas and those interests not so entitled have presented substantial difficulties. The latest effort to rationalize the decisions was made in *Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308, 313-314:

> "In determining which parties are entitled to depletion on oil and gas income, this Court has relied on two interrelated concepts which were first formulated in *Palmer* v. *Bender*, 287 U. S. 551. There, the taxpayer, a lessee of certain oil and gas properties, had transferred his interest in these properties to two oil companies in return for a cash bonus, a future payment to be made 'out of one-half of the first oil produced and saved,' and an additional royalty of one-eighth of the oil produced and saved. In upholding the taxpayer's right to depletion on all such income, the Court based its decision on the grounds that a taxpayer is entitled to depletion where he has: (1) 'acquired, by investment, any interest in the oil in place,' and (2) secured by legal relationship 'income derived from the extraction of the oil, to which he must look for a return of his capital.' 287 U. S., at 557.
>
> "These two factors, usually considered together, constitute the requirement of 'an economic interest.' This Court has found the requisite interest in the oil in place to have been retained by the assignor of an oil lease, *Thomas* v. *Perkins*, 301 U. S. 655, the lessor of oil properties for a share of net profits, *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599, and the grantor of oil lands considered as an assignor of drilling rights,

Burton-Sutton Oil Co. v. *Commissioner,* 328 U. S. 25. The Court found no such interest in the case of a processor of natural gas who had only contracted to buy gas after extraction, *Helvering* v. *Bankline Oil Co.,* 303 U. S. 362, and in the case of a former stockholder who had traded his shares in a corporation which owned oil leases for a share of net income from production of the leased wells, *Helvering* v. *O'Donnell,* 303 U. S. 370.

> "The second factor has been interpreted to mean that the taxpayer must look *solely* to the extraction of oil or gas for a return of his capital, and depletion has been denied where the payments were not dependent on production, *Helvering* v. *Elbe Oil Land Co.,* 303 U. S. 372, or where payments might have been made from a sale of any part of the fee interest as well as from production. *Anderson* v. *Helvering,* 310 U. S. 404."

As the Court there said (350 U. S. at 314), "The problem revolves around the requirement of an interest in the oil in place," and the earlier cases cited illustrate the complexities of that problem. Thus, in *Kirby Petroleum Co.* v. *Commissioner,* 326 U. S. 599, 605-606, the Court was required to "explain" *Anderson* v. *Helvering,* 310 U. S. 404; *Helvering* v. *Elbe Oil Land Co.,* 303 U. S. 372; and *Helvering* v. *O'Donnell,* 303 U. S. 370. Similarly, in *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U. S. 25, 29-37, the prevailing opinion was occupied with extensive "explanations" of the *Elbe Oil Land Co.,* which had just been "explained" a few months earlier in *Kirby Petroleum.* This prompted one of the Justices to say (328 U. S. at 38),

> "Nothing better illustrates the gossamer lines that have been drawn by this Court in tax cases than the distinction made in the Court's opinion

between *Helvering* v. *Elbe Oil Land Co.*, 303 U. S. 372, and this case. To draw such distinctions, which hardly can be held in the mind longer than it takes to state them, does not achieve the attainable certainty that is such a desideratum in tax matters, nor does it make generally for respect of law.'"[9]

If, as many judges have insisted, "Cases that are not argued are not well decided," then it is certainly significant that—because of the illness of counsel—*Burton-Sutton* went unargued for the Government. See J. Sup. Ct., Oct. T. 1945, pp. 195, 196, 199. No doubt the case was not intended to mark a new departure. But doctrinal fission in this Court—or what appears to be such—is all too apt to cause a chain reaction below, and soon the Fourth Circuit was relying on *Burton-Sutton* to grant depletion to a mere contractor, and thus to alter completely the basic concept of the mineral depletion allowance. *Commissioner of Internal Rev.* v. *Gregory Run Coal Co.*, 212 F. 2d 52 (C. A. 4), certiorari denied, 348 U. S. 828. Even the question was stated in terms that reflected the deviation (p. 55): "The question involved is whether the taxpayer, who mined the coal under the contracts herein described, as distinguished from the taxpayer, who held the leases on the coal land,

---

[9] See *Matagorda Shell Co.*, 29 T.C. 1060, 1070: "Admittedly, to paraphrase [the foregoing excerpt], the many cases dealing with this question have drawn gossamer distinctions, which can hardly be remembered for longer than it takes to state them, between those who do and those who do not possess an economic interest in the mineral product."

Compare the remark attributed to Professor Samuel Williston in connection with a thin distinction, "I can state it, but don't ask me to repeat it."

had such an *economic interest in the operation* as to entitle it to take the deduction for depletion allowed by the federal statutes."

We have added the italics to emphasize the extent of the departure from economic interest representing a capital investment in the mineral deposit, which was the essential limitation attached to the "economic interest" concept as first formulated in *Palmer* v. *Bender*, 287 U. S. 551, and as restated by Hughes, C. J., in *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366-368 (both quoted *supra*, pp. 17-20).

And, relying on *Burton-Sutton*, the Fourth Circuit in the *Gregory Run* case then allowed the contractor a depletion allowance, concluding (212 F. 2d at 61) that, "in the pending case the rights of the producers were completely dependent upon the extraction of the salable product and that consequently they were entitled to share in the benefits of the statute which were designed to give compensation to persons interested in the production of a wasting asset."

To the contrary, as Chief Justice Hughes was at pains to point out in the *Bankline Oil* case (303 U. S. at 367), "the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit."

The Third Circuit espoused the deviation of the Fourth in *Commissioner of Internal Rev.* v. *Mammoth Coal Co.*, 229 F. 2d 535, certiorari denied, 352 U. S. 824, and allowed depletion to a coal stripper, on the ground (p. 537) that "the interest which the stripper acquired in the case at bar was sufficiently significant to entitle

it to percentage depletion." Some stress was apparently laid on the stripper's use of machinery worth about a million dollars. But the emphasis in this Court's depletion cases is not on investment in machinery, where the owner is allowed a depreciation allowance, but on capital investment in the mineral deposit, which the stripper plainly did not have.

We need not dwell overly long on *Mammoth Coal*, because the Third Circuit in the case at bar appears now to have abandoned the aberrations of that case, and because, in the decision following *Mammoth Oil* in the reports, the Ninth Circuit emphasized and returned to the underlying concepts formulated by this Court.

That decision was *Usibelli* v. *Commissioner of Internal Revenue*, 229 F. 2d 539 (C. A. 9), which denied depletion to a stripper mining Government owned lands on the ground essentially that he had no interest by investment in the coal in place. In the course of the decision, the Ninth Circuit dispelled a widespread misconception regarding the depletion allowance, saying (229 F. 2d at 541):

> "The depletion deduction allowed by these sections is *not* to be construed, as petitioner contends, as a reward to those persons who actually mine the coal for the risks inherent in extraction. In common with industry generally those engaged in extraction of minerals on a for-hire basis receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working."

The court emphasized the basic requirement of a capital investment in the mineral in place which is

necessarily reduced as the mineral is extracted, adding (229 F. 2d at 543), "Obviously then not every person engaged in the extraction of a mineral can claim a depletable interest." The court continued (229 F. 2d at 543):

> "Certainly, the individual miners cannot be said to possess a depletable interest in the mineral even though their jobs depend upon its continued availability. Nor can the railroad transporting the coal to the breaker, or the contractor operating the breaker, claim a sufficient economic interest to warrant a depletion deduction even though exhaustion of the mineral deposit would drastically curtail their revenue. Such persons may be said to derive an economic advantage from the continued extraction of the coal,
>
> 'But the phrase "economic interest" is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit.' [citing *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 367; *Helvering* v. *O'Donnell*, 303 U. S. 370, 372]"

And, concluding that (229 F. 2d at 546) "petitioner by the contract acquired an economic advantage but no economic interest in the coal in place," the Ninth Circuit approved the Tax Court's denial of a depletion allowance to the stripper.

We return again to the Fourth Circuit, which in *Weirton Ice & Coal Sup. Co.* v. *Commissioner of Int. Rev.*, 231 F. 2d 531, again allowed a stripper to deduct a depletion allowance. The court's opinion emphasizes the misconceptions on which its decision was rested.

Thus, at p. 534, the court said: "It is well established that the purpose of the depletion allowance

provisions of the statute was to encourage the exploration of natural resources which are exhausted upon recovery * * *." Not so; see pp. 22-24, *supra*, and the quotation at p. 29 from *Usibelli*. The purpose is to compensate the owner of a wasting asset for using up that asset in the course of his business, just as a factory owner is allowed a depreciation allowance on his machinery, or a professional man on his furniture.

Again (231 F. 2d at 535), "No stronger proof that Weirton had in effect the right to mine the coal could be found than in its willingness to invest $500,000 in the enterprise." But taxpayers who invest in "the enterprise" are not entitled to a depletion deduction, it is only taxpayers who invest in a mineral deposit who are granted that allowance.

Proceeding on those misconceptions, it is not surprising that the Fourth Circuit, following *Gregory Run* and *Mammoth Coal*, granted the contractor a depletion allowance—and held (231 F. 2d at 536) that there was no conflict with *Usibelli* because there the contractor did not have the right to mine to exhaustion! Why that factor should make any difference is not explained; nor could it be, since the allowance is available without regard to actual exhaustion. See pp. 42-44, *infra*.

In *Commissioner of Internal Rev.* v. *Hamill Coal Corp.*, 239 F. 2d 347 (C. A. 4), the same question arose in another context, because the taxpayer was the lessee, and the question was whether its depletion allowance was to be shared with its contractor, Daniel Coal Company. The taxpayer-lessee built the tipple, designated the areas to be mined, paid the contractor an agreed rate regardless of the market price, and

mined additional coal after terminating its contract with Daniel. The Fourth Circuit followed its earlier decisions and held that the contractor in those circumstances was entitled to a depletion allowance, with a consequent reduction in the allowance available to the taxpayer. The same fallacies as those heretofore exposed underlie the reasoning of the court.

E.g., "These observations [as to the details of the arrangement] are pertinent but when the whole case is considered they do not justify the conclusion that Daniel had no economic interest in the enterprise, as that phrase has been interpreted by the Courts" (239 F. 2d at 350). E.g., "In our opinion these conditions created an economic interest in the mineral in place not only in the taxpayer but also in Daniel, both of whom made a substantial investment and took a substantial risk dependent upon the successful sale of the coal" (239 F. 2d at 350-351).

But unless there is an investment in the mineral, mere economic interest in the enterprise does not establish any right to the depletion allowance; all that is then involved is "economic advantage" in the sense defined by Chief Justice Hughes in *Bankline Oil* (*supra*, pp. 19-20), and from thence carried verbatim into the regulation (*supra*, pp. 20-21).

Finally, in *Stilwell* v. *United States*, 250 F. 2d 736, the Fourth Circuit allowed depletion to the contractor with Paragon Jewel, now *amicus curiae* here, in disregard of specific findings of fact that the contract was terminable at will, and that the contractor bore no risk of fluctuating market prices. See pp. 7-8, *supra*. We think that both factors negatived any economic interest of the Stilwells in the coal, as distinguished

from economic advantage in a contract providing for extraction of the coal; and certainly the Stilwells did not invest a penny of capital in the coal deposits.

It remains only to consider the dissenting views of Judge Kalodner in the companion case of *Huss* v. *Smith* (No. 305, R. 82-85), where he declared the lessee's assumption of the risk of the market to be irrelevant, and said (No. 305, R. 84):

> "It is the possibility of profit from the use of rights over production dependent upon the extraction of the mineral which marks an economic interest. No money need be invested in the mineral deposit. Commissioner v. Southwest Exploration Co., 350 U.S., at page 312."

The foregoing excerpt ignores the rationale of the depletion allowance and misstates the *Southwest Exploration* case.

Southwest Exploration represented a unique factual situation, where the taxpayer conducting the actual mining could not do so except through use of another's land, and this Court was at pains so to limit its decision. The Court said (350 U.S. at 317):

> "We decide only that where, in the circumstances of this case, a party essential to the drilling for and extraction of oil has made an indispensable contribution of the use of real property adjacent to the oil deposits in return for a share in the net profits from the production of oil, that party has an economic interest which entitles him to depletion on the income thus received."

There is no necessity now to reconsider the result in *Southwest Exploration*, but plainly it should be limited,

as this Court limited it, to the precise facts there involved. So limited, it does not help petitioners here, for two reasons: First, they cannot bring themselves within its narrow ambit. Second, as we point out below in Point IV (*infra*, pp. 47-56), Congress in 1951 made such a far-reaching change in the depletion allowance insofar as coal is concerned that the later oil and gas cases can no longer be deemed controlling in the case at bar or in any other cases involving coal.

III. THE RESULT BELOW IS CLEARLY RIGHT ON THE BASIS OF THE FACTS AND OF THE SETTLED ADMINISTRATIVE RULINGS APPLYING TO THOSE FACTS.

Petitioners here cannot prevail under any of the criteria heretofore held controlling as reasons for denying any right to percentage depletion.

A. Petitioners are not entitled to a depletion allowance because they have neither made nor acquired any capital investment in the coal in place.

First and foremost, petitioners have neither made nor acquired any capital investment in the coal they mined.

They invested in machinery (Fdg. 31, R. 21-22), and to the extent that this investment was used up in their operations, they had the right to deduct depreciation. Sec. 23(l), I.R.C. 1939; Sec. 167, I.R.C. 1954.

Petitioners also built roads and power lines in connection with their stripping activities, the cost of which was included in their compensation (Fdg. 23, R. 17-18). To the extent that petitioners' expenditures in respect of roads and power lines were properly treated as non-capital, they were plainly deductible as ordinary and necessary business expenses (§ 23(a), I.R.C. 1939; § 162(a), I.R.C. 1954); and to the extent that

such expenditures were to be regarded as capital, they were subject not only to deductions for depreciation, but also to capital or ordinary loss treatment with applicable carry-backs if these assets were thereafter disposed of for less than their book value. See generally §§ 111, 112, 117, 122, I.R.C. 1939; §§ 172, 1001, 1002, 1211, 1212, 1231, I.R.C. 1954. (It is not now necessary to particularize the provisions governing specific applications of the governing principles laid down in the sections cited.)

But petitioners did not invest any capital in the coal—the wasting mineral asset. That is to say, they did not make the particular investment that is the prerequisite to any allowance for percentage depletion. See pp. 17-22, *supra*. As the Court below said (R. 38),

> "The commitment of capital as an investment in the exploitation of a given mineral must be real and unequivocal. Otherwise, mining contractors, like contractors generally, must look to 'receive their tax benefit through depreciation and obsolescence allowances, and not through an allowance for the depletion of the mineral deposit on which they happen to be working.' See *Usibelli* v. *Commissioner of Internal Revenue, supra,* 229 F. 2d at 541."

See also the opinion of the court below in the companion case (No. 305, R. 68-69).

The Tax Court, which with some lapses[10] has steadfastly stressed the requirement of a capital investment in the mineral in place—commendable loyalty to the doctrines of this Court which has all too frequently been rewarded only with reversal by courts of

---

[10] E.g., *James Ruston*, 19 T.C. 284; *Helen C. Brown*, 22 T.C. 58; *Virginia B. Coal Co.*, 25 T.C. 899; *Denise Coal Co.*, 29 T.C. 528.

appeals[11]—in one of its latest decisions has returned to the concepts first formulated by this Court. See *Nathan Fink*, 29 T.C. 1119, 1129:

> "True, petitioners had an investment in buildings, roads, and equipment. However, all of these assets were subject to an allowance for depreciation, and it is to depreciation deductions that petitioners must look for the recovery of their capital investment. To hold otherwise under the circumstances of this case where the taxpayers have no investment in the minerals in place, we would have to assume that Congress intended the depletion allowance to be a purely gratuitous benefit, over and above a reasonable allowance for depreciation, available to any taxpayer who has some 'connection' with mineral extraction and without regard to whether the taxpayer has an investment in the minerals in question.

It is of no consequence that, as the dissenting judge urged in the companion case (No. 305, R. 84), "the taxpayers depended solely upon production for their return." So did the miners whom the taxpayers employed.

Petitioners argue (Pet. Br. 22):

> "Parsons contributed far more than its tangible property. It staked its entire business operation, including its know-how, payroll and equipment, on the gamble that marketable coal could be discovered and exploited. This was its investment."

It is sufficient to say that such an investment does not measure up to the essential prerequisite for entitlement to percentage depletion, and for this simple, basic

---

[11] The Fourth Circuit reversed the Tax Court's depletion rulings in the *Gregory Run* (*sub nom. J. E. Vincent*, 19 T.C. 501), the *Weirton* (24 T.C. 374), and the *Hamill* (23 T.C. 1120) cases; the Third Circuit reversed the Tax Court in *Mammoth Coal* (22 T.C. 571).

reason: It does not amount to a capital investment in the coal in place.

The question does not turn on the source of the taxpayer's income, but on the ownership of the mineral from which that income is derived. As this Court said of *Palmer* v. *Bender*, 287 U.S. 551, the case that coined the not entirely happy "economic interest" expression, "If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. Ownership was essential." *Thomas* v. *Perkins*, 301 U.S. 655, 661.

And ownership is still essential, as another regulation applicable to this case plainly shows.

Section 29.23(m)-1(i) of Treas. Reg. 111 provides in pertinent part:

> " 'The property', as used in section 114(b)(2), (3), and (4) [of I.R.C. 1939] and sections 29.23 (m)-1 to 29.23(m)-19 [of these regulations], inclusive, means the interest owned by the taxpayer in any mineral property. * * *"

We therefore ask, just what interest did petitioners own in the mineral property of the Rockhill Coal Company? The obvious answer is, None. Petitioners owned no interest in the coal property here in question because they never invested in the coal in place.[12]

---

[12] Virtually identical provisions appear in the earlier and later regulations under I.R.C. 1939; see Treas. Reg. 103, § 19.23(m)-1(i), and Treas. Reg. 118, § 39.23(m)-1(i).

The foregoing regulations have since been codified in I.R.C. 1954 as § 614(a), as follows:

"(a) **General rule.**—For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term 'property' means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land."

B. Petitioners are not entitled to a depletion allowance because their compensation was at a fixed price, without regard to the market, so that they were being paid simply for mining coal belonging to another rather than disposing of an asset in which they had invested and therefore owned.

A particularly important factor negativing any ownership interest in the mineral deposit is the circumstance, present here (Fdgs. 22-23, R. 15-18; R. 26-28, 35-36) and in the companion case (No. 305, Fdg. 16, R. 31; Fdgs. 27-29, R. 34; R. 41-43, 68), that the contract arrangement provided for the stripper to receive a stipulated price for all coal delivered to the landowner, regardless of its market price at the time of delivery. If the market fell, the landowner and not the stripper absorbed the loss; if it rose, the profit inured to the landowner's benefit, not to the contractor's. Such arrangements are consistent only with the notion that the owner of the land owned the coal, that he bore the burdens and the benefits of ownership as the case might be, and that the contractor was paid for the labor of extracting a mineral that belonged to another. It would indeed be a strange sort of ownership if the contractor could be insulated from fluctuations in the sale price of the product that he purportedly owns. Accordingly, a good many decisions consider a fixed price per ton a virtually conclusive criterion for denying the contractor any percentage depletion (e.g., *Morrisdale Coal Mining Co.*, 19 T.C. 208; *Matagorda Shell Co.*, 29 T.C. 1060; *Nathan Fink*, 29 T.C. 1119); and we have pointed out how the Fourth Circuit, which allowed depletion to taxpayers contracting with *amicus curiae* (*Stilwell* v. *United States*, 250 F. 2d 736), ignored the district court's finding that the contract

there involved called for a fixed price. See pp. 7-8, *supra*.

But while we agree that a fixed-price contract suffices almost automactically to bar the contractor's claim to any share in the allowance for percentage depletion, we do not accept the contrary consequence, and thus disagree with the rulings (e.g., *James Ruston*, 19 T.C. 284; *Helen C. Brown*, 22 T.C. 58; *Virginia B. Coal Co.*, 25 T.C. 894; *Walter Bernard McCall*, 27 T.C. 133) which hold that the stripper is entitled to depletion simply because his compensation for extracting the coal is measured by a percentage of the price at which it is ultimately sold.

Where the contract is thus drawn, it is true that the contractor takes the risk of the market. Most contractors do, in greater or less degree. But such a profit-sharing arrangement—or loss-sharing, as the case may be—does not supply the primary requirement that the coal deposit being depleted must represent the taxpayer's capital investment. Ownership is essential, *Thomas* v. *Perkins*, 301 U.S. 655, 661; Treas. Reg. 111, § 29.23(m)-1(i), and the circumstance that the owner of the mineral finds another to share both his risks of loss and his hopes of gain does not amount to a transfer of ownership sufficient to justify a depletion allowance for the contractor who has no capital investment in the mineral in place.

C. Petitioners are not entitled to a depletion allowance because their contracts were terminable at the will of the owner of the coal lands.

In this as well as in the companion case, the district court found that the strippers' contracts were terminable at the will of the landowner (Fdgs. 17-18, R. 13-14; No. 305, Fdgs. 30-31, R. 34-35), and both courts below

relied on this circumstance in denying the strippers any percentage depletion (R. 26, 35, 36-38; No. 305, R. 38-41, 68-69). Some rulings in other cases similarly attach considerable weight to indicia of terminability. E.g., *Usibelli* v. *Commissioner of Internal Revenue,* 229 F. 2d 539 (C.A. 9); *Nathan Fink,* 29 T.C. 1119, 1127; and compare the disregard of the finding of terminability in the *Stilwell* case, discussed at pp. 7-8, *supra.*

The dissenting judge below (R. 47; No. 305, R. 82-84) considered the right to terminate irrelevant, essentially on the ground that the possibility of termination does not affect the present existence of an "economic interest," and his view has some support in decisions which, for reasons already set out at length (*supra,* pp. 27-37), must be deemed erroneous. See *Mammoth Coal,* 229 F. 2d at 538, 539; *Weirton,* 231 F. 2d at 535.

We consider the fact of a termination right significant, not in and of itself, but as symptomatic, and for this reason: It is extremely unlikely—indeed, it would be utterly incomprehensible—that any reasonable man would invest his capital on terms that could wipe him out, at any time and without any compensation, simply at another's whim. Therefore while the absence of a termination clause does not establish affirmatively that the stripper has made a capital investment, the presence of such a clause is a conclusive indication that the stripper has not invested any capital in coal but has merely made a contract with the owner of the coal for its extraction.

To that extent, therefore, the presence of a termination clause is highly relevant, and we therefore agree

with the court below in denying petitioners a depletion allowance for that reason. We believe, however, that a sounder rationale would place more emphasis on the absence of capital investment which the termination clause reflects, and less on that clause itself.

We have already pointed out (page 24, *supra*) that in the present case petitioners insisted on a termination clause in order that they might be free to engage in other pursuits for which their experience and their equipment fitted them (R. 35; Fdg. 15, R. 12).

D. Petitioners' contracts here were non-exclusive, but the factor of exclusiveness, even if present, would not entitle them to any depletion allowance.

The findings in the case at bar show that petitioners' contract was not exclusive (Fdg. 20, R. 15), and that other contractors succeeded them in the same areas (Fdg. 29, R. 20-21); and those facts were mentioned in the opinion below (R. 35).

Certain other cases, on the other hand, have found support for a holding that the contractor had the right to a depletion allowance in the fact that he had the exclusive right to mine. E.g., *Mammoth Coal*, 229 F. 2d at 538; *Hamill*, 239 F. 2d at 350; *James Ruston*, 19 T.C. 284; *Walter Bernard McCall*, 27 T.C. 133, 136; and see the views of the dissenting judge in the companion case (No. 305, R. 84).

We think that exclusiveness *vel non* in these cases is a fact of commercial interest that has no legal significance. Obviously, it is not feasible to have two contractors with independent interests mining or attempting to mine the same area simultaneously. Any such effort in stripping operations would set off a race of diligence with dangers of violence recalling the

old-time construction of railroads by rival companies along substantially identical routes; while in drift-mining, which requires blasting to loosen the coal, non-exclusive mining would plainly be unsafe and in all likelihood fatal to all concerned.

Insofar as a non-exclusive contract contemplates, not simultaneous mining by two contractors, but termination by one followed by further operations by another, the considerations are identical with those already canvassed (pp. 39-41, *supra*) in connection with the significance of the termination clause.

E. Petitioners' contracts here did not call for exhaustion of the deposit where they were operating, but even contracts providing for mining to exhaustion do not by reason of that factor alone entitle the stripper to percentage depletion.

In the case at bar, petitioners did not have a contractual right, nor a contractual obligation, to mine the tract to exhaustion (Fdg. 18, R. 14; Fdg. 30, R. 21), and the court below relied heavily on that circumstance (R. 35, 36, 37, 38) in denying petitioners any right to percentage depletion.

In the companion case, while there was similarly no right or obligation to mine to exhaustion (No. 305, Fdg. 17, R. 31; Fdg. 31, R. 35), the stripper there did mine until by mutual agreement further work was deemed unprofitable, and the court below noted (No. 305, R. 68) that "In this sense Huss did mine the deposit to exhaustion." The court accordingly rested its denial of percentage depletion on the termination clause (No. 305, R. 68-69).

Other cases attach substantial weight to the circumstance that the contractor involved undertook, or was permitted, to mine a particular area to exhaustion.

E.g., *Mammoth Coal.*, 229 F. 2d at 538; *Weirton*, 231 F. 2d at 536; *Hamill*, 239 F. 2d at 348.

We confess ourselves unable to perceive any connection between the right to mine an area to exhaustion and the right to a depletion allowance in the mineral. The latter allowance belongs to the owner of the mineral, whose capital asset is being depleted. The circumstance that the contractor's work will eventually come to an end does not, standing alone, entitle him to an allowance for the depletion of another's capital asset which he has contracted to mine, any more than the same exhaustion factor entitles the individual miner who is employed by the contractor to deduct a similar allowance.

Most contracts for the completion of a particular job necessarily contemplate an eventual exhaustion of the work, whether that work consists of putting up a building, or of constructing a dam, or of litigating a lawsuit. But in none of those instances does the fact that the subject-matter of the contract will inevitably become exhausted give the contractor such a capital interest in the subject-matter as will entitle him to a depletion allowance for the progressive diminution of the value of his contract.

We submit that the exhaustion factor is in consequence completely irrelevant in considering whether the contractor has any right to deduct for percentage depletion. Since the rationale of the depletion allowance is, simply and solely, compensation for a capital asset acquired by investment that is being used up in the process of producing income (*United States* v. *Ludey*, 274 U.S. 295, 302, 303; *Palmer* v. *Bender*, 287 U.S. 551, 558; *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366-

367, 368; all discussed at length above, pp. 15-20), it is obvious that the decisions which stress the exhaustion factor while simultaneously ignoring the absence of any capital investment, are, very plainly, misinterpreting and misapplying the statute.

F. Petitioners are not entitled to percentage depletion under applicable Treasury regulations and interpretations.

We have already shown (*supra*, pp. 20-21) that the Treasury Regulation applicable to the present case (Treas. Reg. 111, § 29.23(m)-1) was, like its predecessor provision in Treas. Reg. 103, taken verbatim from this Court's differentiation, in the *Bankline Oil* opinion, between an economic interest acquired by investment, and a mere economic advantage resting on contract and not deriving from investment.

That regulation dates from 1939 (*supra*, p. 20), and, in essentially the same form, will govern all income taxes up to the effective date of the 1954 Internal Revenue Code. Consequently if this provision is given the weight normally accorded "regulations and interpretations long continued without substantial change" (*Helvering* v. *Winmill*, 305 U.S. 79, 83), then, plainly, the taxpayer contracting with a lessee of coal lands, be he stripper or drift miner, cannot successfully claim a depletion allowance, for two reasons:

First. Under that regulation, petitioners here have only an "economic advantage" and not a "depletable economic interest," because they have not acquired, by investment, an interest in the coal in place.

Second. Since petitioners' return does not fluctuate with the market, their income is not "derived from the severance *and* sale of the mineral"; our italics.

Treasury interpretations of the foregoing regulation similarly preclude recovery by petitioners here. Thus, in a ruling of the Bureau's General Counsel (G.C.M. 26290; Cum. Bull. 1950-1, p. 42, at p. 45), it was said:

> "It is not the view of this office, however, that the deduction for depletion is to be granted in every case. On the contrary, it seems clear that the allowance is warranted only where, under the agreement between the parties, the stripping contractor obtains a capital interest in the mineral in place and must look to the severance and sale of the mineral for the return of capital consumed in that process. (See G.C.M. 22730, supra). In this respect, it is noted that in some instances contracts may be cancelled by the coal company at will. Under such circumstances, it would appear that the contractor receives no binding right to extract the mineral and thus fails to obtain a capital interest therein. Lacking such an interest in the mineral, it follows that the contractor cannot properly claim a deduction for depletion.
>
> "In the opinion of this office, a contract which is terminable by the coal company at will, and which thus fails to vest in the contractor the requisite capital interest in the mineral in place is one in which the coal company has an absolute right to cancel at any time without cause or condition * * *.
>
> "One of the contracts examined shows that the coal company reserves the right, without payment of damages, to 'suspend' work indefinitely at any time or from time to time; under another contract the coal company is given the right, upon 5 days' notice to the contractor and without payment of damages, to 'suspend" work for an indefinite period; and under a third contract the coal company may 'suspend' operations during such time or times as the company operates at a loss

> because of the minimum payable to the contractor. Since contracts of this character, despite the power of indefinite suspension provided for therein, do not, except under specific conditions, appear to permit the coal company to dismiss contractors absolutely and substitute others to extract the minerals, it is the opinion of this office that such contracts should not be classified as contracts which may be cancelled 'at will'."

It would unduly extend this already full discussion to cite even the leading cases here on the proposition that administrative regulations and interpretations by the Treasury and the Internal Revenue Service which are consistent with a statute are entitled to substantial and often well-nigh conclusive weight. Yet in this instance the doctrine for which petitioners contend, and which some courts, notably the Fourth Circuit, have adopted (*supra*, pp. 27-33; see list of Tax Court reversals in note 11, p. 36), is wholly at variance with those regulations and interpretations over the years.

The rule that gives at least respectful recognition to administrative progress reflects the actualities of government. We submit that this rule should not be applied in every case except this one alone.[13]

---

[13] It has already been pointed out (*supra*, pp. 5-8) that there are significant business and technical differences between the stripper and his expensive equipment and the drift-miner with his meager and much simpler tools. Therefore the case against allowing percentage depletion to the contractor carrying on drift-mining is an *a fortiori* one. But inasmuch as the stripper under the foregoing rationale is so very plainly without entitlement to any depletion allowance, we do not feel justified in troubling the Court with the necessarily cumulative if more dramatic factors which pertain only to the drift-miner.

This is particularly so because, as we shall now show, Congress in 1951 made such a significant change in the tax treatment of coal royalties that there is no longer any ground on which contractors can rest claims to percentage depletion.

IV. THE LEGISLATION WHICH SINCE 1951 HAS PERMITTED THE LESSOR OF COAL LANDS TO CAPITALIZE HIS ROYALTY INCOME AS A SUBSTITUTE FOR A SHARE OF THE DEPLETION ALLOWANCE CONSTITUTES AN ADDITIONAL REASON WHY A MERE CONTRACTOR IS NOT ENTITLED TO ANY PORTION OF SUCH ALLOWANCE.

For the tax years involved in the present case, the pertinent provision on which petitioners' case must stand or fall—as they and their associated petitioners fully recognize (Pet. Br. 2, 8, 28; Pet. Br., No. 305, 2, 6, 8, 19)—is the portion of § 23(m), I.R.C. 1939, which provides that "In the case of leases the deductions shall be equitably apportioned between the lessor and the lessee."[14]

But, so far as coal is concerned, the situation with respect to percentage depletion has been radically altered, by legislation which counsel in coal depletion cases do not appear to have cited, and of which the courts still appear to be unaware.

Ever since 1951, effective with respect to taxable years ending after December 31, 1950, the lessor of coal lands who is neither a co-adventurer, partner, or principal in the actual mining of the coal has been accorded capital gains or losses treatment in respect of his royalties, and in return for that boon he is denied any percentage depletion allowance. This provision was introduced by § 325(b) of the Revenue Act

[14] As has already been pointed out (note 3 at pp. 16-17, *supra*), the substance of this sentence was included in every basic revenue act from 1918 through 1954.

of 1951 as an amendment to § 117(k)(2), I.R.C. 1939. It provides as follows:

> "(2) In the case of the disposal of timber or coal (including lignite), held for more than 6 months prior to such disposal, by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber or coal, the difference between the amount received for such timber or coal and the adjusted depletion basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber or coal. Such owner shall not be entitled to the allowance for percentage depletion provided for in section 114(b)(4) with respect to such coal. This paragraph shall not apply to income realized by the owner as a co-adventurer, partner, or principal in the mining of such coal. The date of disposal of such coal shall be deemed to be the date such coal is mined. In determining the gross income, the adjusted gross income, or the net income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this paragraph. This paragraph shall have no application, in the case of coal, for the purposes of applying section 102 or subchapter A of chapter 2 (including the computation under section 117(c)(1) of a tax in lieu of the tax imposed by section 500)."[15]

Accordingly, when §§ 23(m) and 117(k)(2) of the 1939 I.R.C. are read together, as of course they must

---

[15] In the 1954 I.R.C., this provision was reenacted as § 631(c), with a clause added to the third sentence of the 1951 text to make plain that its benefits should apply also to sublessors, viz.: "• • • and the word 'owner' means any person who owns an economic interest in coal in place, including a sublessor." See also pp. 51-53, *infra*.

be,[16] there is no longer any depletion deduction to be "equitably apportioned between the lessor and the lessee," for the very good reason that the lessor is no longer entitled to percentage depletion. Congress amended the statute, in the face of a loss of revenue occasioned thereby, because the coal lessor was at a disadvantage under the percentage depletion method (H.R. Rep. 586, 82d Cong., 1st sess., pp. 31-32; Sen. Rep. 781, 82d Cong., 1st sess., pp. 42-43; Sen. Rep. 781, 82d Cong., 1st sess., Part 2, pp. 43-45), even with the coal depletion percentage raised from 5% to 10%, as it was by § 319(a) of the same Revenue Act of 1951, amending § 114(b)(4)(A)(ii), I.R.C. 1939.

The Senate Committee was at pains to provide that the capital-gains-treatment-in-lieu-of-percentage-depletion provisions did not apply to a lessee. Sen. Rep. 781, 82d Cong., 1st sess., p. 43.

The fact is that, since 1951, the lessor of coal lands has been placed on a footing wholly different, with respect to depletion allowance, from that of the lessor of oil and gas lands. It follows that the cases in this Court, which have dealt almost exclusively with the treatment to be accorded to the fractionalizations of leasehold interests in oil and gas, under § 23(m), I.R.C. 1939, and under identical or substantially identical predecessor provisions, cannot be mechanically applied

---

[16] "There is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts." *Duparquet Co.* v. *Evans*, 297 U. S. 216, 218. See also Cardozo, J., dissenting in *Panama Refining Co.* v. *Ryan*, 293 U. S. 388, 433, 439: "• • • the meaning of a statute is to be looked for, not in any single section, but in all the parts together and in their relation to the end in view. [Citing many cases]."

to what is now the very different situation of the depletion allowance in respect of coal.

Since, therefore, the coal lessor is no longer entitled to percentage depletion, there is nothing now to be apportioned, and all percentage depletion belongs indivisibly to the lessee. Accordingly, the lessee is no longer obliged to share his allowance with anyone.[17] This circumstance completely undercuts any claim by a mere contractor to any percentage depletion, for the contractor, plainly enough, cannot be assimilated to a lessor who is a participant in mining the coal.

Nor can it be contended that, as to tax years subsequent to 1950, a taxpayer who contracts with a coal lessee to mine coal on the leased property can be considered as somehow included within the term "lessee" so as to share in what since 1951 has become an indivisible allowance. For Congress well knew the difference between a lessee of wasting asset property and a contractor whose activities resulted in depleting that property.

The coal lessor's capital gains section as amended in 1951 is § 117(k)(2), I.R.C. 1939, which deals also with certain aspects of the disposition of lumber. Sec. 117(k)(1), I.R.C. 1939, which was left unchanged in 1951, provides in its first sentence:

> "If the taxpayer so elects upon his return for a taxable year, the cutting of timber (for sale or

[17] The lessee computes his percentage depletion on gross income from the mining property, but must for that purpose exclude from such gross income the amount of any rents or royalties paid in respect of the property. § 114(b)(4)(A), I.R.C. 1939; § 613(a), I.R.C. 1954. To that extent his status as a lessee diminishes his allowable deduction for depletion. But, since 1951, the lessee of coal lands need no longer divide depletion, *qua* depletion.

for use in the taxpayer's trade or business) during such year by the taxpayer who owns, *or has a contract right to cut,* such timber (providing he has owned such timber or has held such contract right for a period of more than six months prior to the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year." [Italics added.][18]

Very obviously, if Congress had intended to provide depletion benefits for one having simply a contract right to mine coal, it would have said so, instead of, by enacting § 117(k)(2), eliminating the coal lessor from the depletion provisions in § 23(m) and thus rendering the depletion allowance in the case of leases an indivisible deduction available only to lessees.

In this connection, it is significant that the restatement of the foregoing provisions in the 1954 Internal Revenue Code emphasizes in even more striking fashion the intent of Congress not to allow any percentage depletion to the taxpayer who simply has a contract to mine coal.

What was § 117(k)(1) of the 1939 Code (quoted in part, just above) became § 631(a) of the 1954 Code. The provision that was § 117(k)(2) in the 1939 Code (quoted in full, supra, p. 48) was divided in 1954 into two subsections, § 631(b) dealing with timber, and § 631(c) relating to coal.

Those latter subsections reveal significant differences.

---

[18] I.R.C. 1954, § 631(a), is the same in substance as the foregoing, and indeed is nearly a verbatim copy thereof.

The last sentence of the timber subsection, § 631(b), states:

> "For the purposes of this subsection, the term 'owner' means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber."

But the coal subsection, § 631(c), provides that—

> "* * * the word 'owner' means any person who owns an economic interest in coal in place, including a sublessor."

These distinctions, which are inherently important, become even more striking when read in the light of the indisputable fact that while coal deposits, like other minerals, are subject to percentage depletion, timber resources are not: §§ 114(b)(3), 114(b)(4), I.R.C. 1939; § 613(b), I.R.C. 1954.

That is to say, while Congress now defines the term "owner" to include the holder of a contract to cut timber, it does not define that word to include the holder of a contract to mine coal. For timber, which is not subject to percentage depletion, it is sufficient to own "an interest in such timber"; for coal, which is subject to percentage depletion, it is necessary to own "an economic interest in coal in place."

This last expression—which was only the second time that the words "economic interest" appeared in the internal revenue laws, the first being in 1951—obviously involves an incorporation of the "economic interest" concept in the sense that it was first expounded in the opinions of this Court, and in

the sense that from there it was copied literally into the Treasury Regulations (*supra*, pp. 20-21).[19]

We submit, therefore, that whether one looks to the 1954 Code, or to the 1951 amendments to the 1939 Code, or to the law as it stood before 1951, only one conclusion is possible: A taxpayer who has a contract to mine coal but who has no capital investment in the coal in place, is not entitled to percentage depletion.

All of the coal depletion cases in courts of appeals cited and discussed at pp. 27-33, 38-44, 46, *supra*, involved tax years prior to 1951, with a single exception: *Stilwell* v. *United States*, 250 F. 2d 736 (C.A. 4), dealt with taxes for the year 1952. Yet none of the three briefs filed in the latter case (C.A. 4, No. 7499) either cited I.R.C. 1939, § 117(k)(2), or discussed the changed position of the coal lessor in respect of sharing in the depletion allowance granted by § 23(m). Nor did the court.[20]

The present case and No. 305 both involve tax years prior to 1951. But we believe that the change in the

---

[19] Petitioners here (Pet. Br. 10-13, 21-22) and in the companion case (Pet. Br., No. 305, 9, 11-15, 17) rely heavily on language found in *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308. But even if that decision is not limited to its precise facts, as we think it must be (*supra*, pp. 33-34), its discussion, dated 1956, can not throw light on, much less control, the meaning of an expression first employed by Congress in 1951.

[20] The same omission is noted in one of the latest of the Tax Court rulings on coal depletion. *Nathan Fink*, 29 T.C. 1119. This case involved the Finks' tax liability for the calendar years 1951 and 1952. Fink was a partner in Perry Construction Co., a firm with tax years ending April 30, 1951, and April 30, 1952. Perry had contracts to mine coal, some with Hudson Coal Co., owner of the fee, and some with Glen Coal Co., which had leased coal lands from Hudson. Plainly, therefore, the 1951 amendments to I.R.C. 1939, § 117(k)(2), were pertinent; but they were not mentioned by the court.

law just set forth, while perhaps primarily important for precluding entirely any claim to depletion by coal mining contractors for tax years after 1950 and for demonstrating in yet another aspect the error underlying the case which allowed depletion to Paragon Jewel's contractor (*Stilwell* v. *United States*, 250 F. 2d 736, *supra*), serves also to underscore the correctness of the rulings below in the cases now under consideration, and the unsoundness of the essentially contrary decisions in the Fourth Circuit.

Very frequently, of course, new legislation is deliberately designed to effect changes in existing law. On occasion, new legislation will be basically declaratory in nature. But sometimes legislation enacted subsequent to the transactions being adjudicated may be, in the words of Judge Learned Hand (*United States* v. *Aluminum Co. of America*, 148 F. 2d 416, 429 (C.A. 2)), "considered to throw a cross light" on what has gone before.

We think that this is such a case—even though the committee reports dealing with the 1951 amendments do not mention the question of the stripper's right to depletion. Those reports could not possibly have mentioned the problem considered in the present case, for the reason that it had not then arisen.

The Revenue Act of 1951 was signed by the President on October 20, 1951. The first Tax Court decision granting a contractor any share in the percentage depletion allowance, *James Ruston*, 19 T.C. 284, was promulgated on November 21, 1952, a year later; and the first court of appeals decision giving a contractor percentage depletion (and reversing the Tax Court in the process) was the *Gregory Run* case, 212 F. 2d 52, decided on April 9, 1954.

Plainly, therefore, the framers of the 1951 amendment, where the words "economic interest" first appeared in the law, could not possibly have anticipated the misapplications of those words now in issue. But, equally plainly, the light which that amendment sheds on the depletion problem underscores both the fallacy of petitioners' position here and the misconception underlying the rationale of the Fourth Circuit cases we have already discussed at such length (*supra*, pp. 27-28, 30-33, 38-44, 46).

We submit, therefore, that the 1951 elimination of the coal lessor as a recipient of any part of the percentage depletion allowance underscores the conclusion, drawn from the seminal decisions in this Court written by Brandeis, J., Stone, J., and Hughes, C. J. (*supra*, pp. 15-20), that the underlying criteria permitting the deduction of a depletion allowance preclude the granting of any part of such allowance to one who merely contracts with the owner or lessee of the coal land, and who has never made any capital investment in the coal in place. The same conclusion follows as an *a fortiori* proposition from the terms of the 1954 Code.

Other factors, while significant (*supra*, pp. 38-44), cannot be controlling where the essential prerequisite of a capital investment in the mineral asset is not present. It is only when that integral qualification of the "economic interest" concept is abandoned, and those two words are bandied about as though they were a slogan shouted from the hustings or peddled by the hucksters, that it has been possible for courts to fall into the egregious error of allowing depletion to the contractor.

But for the economic consequences which that error threatens to wreak upon *amicus curiae*, the Fourth

Circuit's decisions on the issue now in question would represent, not only an interesting illustration of Mr. Justice Holmes' observation (*Hyde* v. *United States*, 225 U.S. 347, 384, 391) that "It is one of the misfortunes of the law that ideas become encysted in phrases and thereafter for a long time cease to provoke further analysis," but also a frightening example of how concentration on the rounded words of a non-statutory expression and disregard of the qualifying language which originally accompanied those words can lead to the complete perversion of a statute.[21]

The 1951 change in the coal depletion provisions, which frees the coal lessee from having to share his percentage depletion deduction with his lessor—the only other party with whom the statute formerly required him to participate—has made the coal lessee's deduction for percentage depletion indivisible. This change illuminates the past, and emphasizes the lack of foundation, at any time, for the contractor's claim to any part of the coal depletion allowance.

[21] Cf. *Guy* v. *Donald*, 203 U.S. 399, 406: "As long as the matter to be considered is debated in artificial terms there is a danger of being led by a technical definition to apply a certain name, and then to deduce consequences which have no relation to the grounds on which the name was applied." (Holmes, J.)

See also *Lowden* v. *Northwestern National Bank*, 298 U.S. 160, 165. "When things are called by the same name it is easy for the mind to slide into an assumption that the verbal identity is accompanied in all its sequences by identity of meaning." (Cardozo, J.)

CONCLUSION

This Court should affirm the judgment below—

1. Primarily on the ground that petitioners did not acquire by investment any interest whatever in the coal in place;

2. Alternatively, on the grounds (a) that petitioners' compensation was neither contingent nor dependent on the price for which the coal was sold, and/or (b) that petitioners' contract was terminable;

3. Additionally on the ground that when Congress in 1951 granted the lessor of coal lands capital gains treatment of his royalties in lieu of his former share in the lessee's percentage depletion allowance, it rendered the coal lessee's depletion allowance indivisible, and hence necessarily confirmed and approved the denial by the court of appeals of any depletion allowance to the contractor in this case.

Respectfully submitted.

FREDERICK BERNAYS WIENER,
Suite 815 Stoneleigh Court,
1025 Connecticut Ave., N. W.,
Washington 6, D. C.,
Counsel for Paragon Jewel Coal Company, Inc., Amicus Curiae.

LE ROY KATZ,
Ritz Building,
Bluefield, W. Va.,
Of Counsel.

FEBRUARY, 1959.

APPENDIX

APPENDIX

APPENDIX A

Form of Typical Paragon Jewel Coal Lease

THIS DEED OF LEASE, . . .

. . . . . .

WITNESSETH: That for and in consideration of the premises, the said Lessors do hereby demise and lease unto the said Lessees, their heirs, successors and assigns, for the period or periods hereinafter mentioned, the sole and exclusive right and privilege of mining and removing, by deep mining or strip mining methods, or both, all of the merchantable and minable coal upon the following tracts or parcels of land, which are situated in Buchanan County, in the State of Virginia, and which are more particularly described as follows:

. . . . . .

It is further convenanted and agreed between the parties hereto as follows:

I.

The Lessees agree to pay to the Lessors a tonnage rent or royalty at the rate of fifteen cents (15¢) per ton for each and every ton of coal of two thousand (2000) pounds mined from the leased premises. The amount of tonnage royalty to be so paid for coal mined shall be determined by actual weight.

It is further agreed between the parties hereto that a minimum royalty of Four Thousand Dollars ($4,000.00) per year shall be payable to the Lessors hereunder by the Lessees on the 1st day of August, 1948, and on the 1st day of each succeeding August thereafter during the life of this contract, and that the sum of Four Thousand Dollars ($4,000.00) covering the minimum royalty for the year commencing August 1, 1948, has been paid by the Lessees to the Lessors, and receipt of which is hereby acknowledged, and such minimum rentals or royalties shall be payable whether sufficient coal to yield such minimum royalty shall be mined at the rate of fifteen cents (15¢) per ton or not. However, if the coal mined in any one

year shall not, at the rate of fifteen cents (15¢) per ton, yield the said minimum royalty, and the Lessees shall have paid the said minimum royalty for such year, then the Lessees shall have the right to mine, within a period of six (6) months in the following year, free of royalty, sufficient coal to yield the said minimum royalty paid in excess of the coal mined in such year, and that the Lessees shall have the privilege, within the next twelve (12) months from this date, of mining, free from royalty, a sufficient amount of coal which will, at the rate of fifteen cents (15¢) per ton, yield the sum of Six Thousand Dollars ($6,000.00), being the sum of money heretofore paid as minimum royalties, as hereinbefore shown. However, it is further agreed that in case the market conditions are such that the Lessees are unable to market or sell their coal, the Lessors will grant to the Lessees the privilege of relief from the minimum royalty, and exclude the payment of such minimum royalty, but for market conditions only.

II.

The tonnage royalties shall be payable on the 25th day of each month for all coal mined during the preceding calendar month, and the Lessees agree that on the 25th day of each month, they will give to the Lessors or mail to them, at their last known post office addresses, a statement showing the amount of coal mined from the leased premises during the preceding calendar month.

III.

The Lessees shall keep books of account, showing the number of tons of coal mined from the leased premises, and said books shall, at all times, during business hours, be open for inspection by the Lessors, their agents or attorneys, for the purpose of comparing and verifying the accounts rendered.

IV.

It is further agreed that the Lessees shall have the right to use all of the surface of said land as is now owned in fee simple by the said Lessors for the purpose of mining

said coal, the construction of any and all other buildings necessary for the carrying on of said mining operation. There is, however, excepted from this right or privilege granted to the Lessees the following:

• • • • • • • • • • •

V.

It is further agreed between the parties hereto that the said Lessees, their heirs or assigns, will pay all land and property taxes assessed against the property herein covered by this lease, beginning with the year 1948, and to continue during the term of this lease or for such period of time as such lease remains in full force and effect. It is agreed between the parties hereto that the said Lessees, their heirs or assigns, are hereby released from damages for injury, if any, which may result to the surface of said land by reason of the mining and removal of the said coal, with the exception of three (3) tracts above described, which are • • •

VI.

The said Lessees, their heirs or assigns, shall also pay all taxes that may be assessed against the improvements, fixtures and machinery and upon all of the coal mined during the continuance of this lease from the said leased premises.

VII.

The Lessees shall work and mine the coal in the most effectual, modern, workmanlike and proper manner and in conformity with the laws now existing or hereafter passed by the State of Virginia, or by the United States of America, regulating the working of mines, drifts, gangways, and other necessary and appropriate openings to and in the beds or veins of coal hereby leased, with openings for airways and ventilating passages for keeping the mines in good working order, to the satisfaction of the engineer of the Lessors; but in case the Lessees shall claim that the requirements of the Lessors' engineer in this regard are unreasonable, then and in that event, the

disagreement thus arising shall be settled by arbitration, as hereafter provided.

VIII.

Whenever reasonable, the Lessees shall drive the regular size of gangways and airways through such portion of said veins or seams of coal as may prove faulty, or may not yield minable and merchantable coal, and shall leave no more coal in the mine opening or workings than in the opinion of the engineer of the Lessors may be necessary and proper for the full security of the mines, and shall leave pillars and supports along the sides of the entries, gangways and elsewhere as the engineer of the Lessors shall consider necessary for such security, and shall mine and recover all of the minable and merchantable coal in said seams or veins of coal which, by the exercise of care and modern mining methods, it is practicable to recover. And any disagreement arising under this clause shall be settled by arbitration, in the manner hereinafter provided for.

IX.

The Lessees shall have the right to rob out and mine the pillars in or along any room or other working place it abandons, which in the opinion of the engineer or other proper officer or appointee of the Lessors, are not necessary to be left for the proper protection and support of the mines, and the said Lessees shall recover all of the minable and merchantable coal that, by the exercise of skill and modern mining methods, can reasonably be recovered.

X.

The said Lessees shall have the right to use the entries, haulways, or other excavations in said mine for the purpose of hauling through said land the coal leased or purchased from any other person than Lessors, but the said Lessees shall pay to the said Lessors two and one-half (2½¢) cents for each and every ton of coal acquired or purchased from any other persons than Lessors and hauled through any of

said entries, gangways, excavations, or haulways through the leased premises, and shall keep a book of accounts showing every ton of coal mined from other lands and hauled through any of the excavations, entries, or haulways on the leased premises, and pay therefor at the rate of two and one-half (2½¢) cents per ton for each ton so hauled, each month at the same time the royalties herein provided to be paid shall be due and payable. However, the Lessors do hereby grant the Lessees the right and privilege to haul Lessees's own coal purchased, owned, or leased over lands leased by Lessees from Lessors on the truckroads, or roads now on the leased premises free of charge. Provided, however, the said Lessees agree to maintain and upkeep the truck roads, or other roads at their own expense.

XI.

The Lessors, their agents, engineers, or other officers, or some other person on their behalf, with their assistants, shall have the right to enter at all reasonable times the mines and all other works on the said leased premises, whether below or on the surface of the ground, in order to inspect, examine, survey or measure the same, or any part thereof, or for any other lawful purpose, and, for those means, to use freely the means of access to the said mines and works without hinderance or molestation.

XII.

It is hereby expressly understood and agreed that all royalties which at any time may be owing to the said Lessors under this contract, shall constitute and are hereby constituted and declared a first and paramount lien upon the premises embraced in this lease, and upon all steel rails, fixtures, appliances and improvements now or hereafter placed thereon.

XIII.

It is further understood and agreed that if at any time during the continuance of this lease the Lessees should be prevented from operating the mines on the leased prem-

ises on account or by reason of general labor strikes prevailing through the Buchanan County Coal Fields, or by reason of failure on the part of the Railroad Companies, after ten (10) days notice by the Lessees, to furnish, without fault on the part of the Lessees, sufficient transportation, then and in either of those events, the minimum royalty provided for in this contract shall be abated until such time as the two causes aforesaid shall have been removed, provided, however, that in no event shall anything be construed as meaning to give relief to the Lessees as to any amount, except as to the difference between the coal actually mined and the amount of said minimum royalty, and provided, further, that there shall in no event be any abatement from said minimum royalty for either or both of the causes mentioned in this clause for a greater length of time than three (3) months in the aggregate in any one year.

XIV.

It is agreed between the parties hereto that should the operation of the mines on the leased premises be stopped by fire, and it becomes incapacitated for work by reason thereof, or solely from other providential cause, the payment of the minimum royalty hereunder shall be suspended until such time as the necessary repairs or rebuilding can reasonably be done.

XV.

If at any time, during the continuance of this lease, a dispute shall arise between the said Lessors and the said Lessees as to whether or not said mines are being worked in a skillful, suitable and proper manner, as herein provided for, or as to any other question involving the construction and effect of this lease, or any part thereof, the dispute or disputes so arising shall be referred to a board of arbitrators consisting of three competent and expert men, one of whom shall be selected by the Lessees, one by the Lessors, and one to be agreed upon by the two thus selected, and should they fail to agree within twenty-four (24) hours upon such a one, then it shall be referred to

the Judge of the Circuit Court of Buchanan County, Virginia, who shall select the third as arbitrator, and the decision of said board of arbitrators shall be final.

XVI.

It is agreed and covenanted by all the parties hereto that this lease shall take effect on the 1st day of August, 1948, and continue for the period of twenty (20) years from the said 1st day of August, 1948, and that the said Lessees, their heirs or assigns, shall have the right to renew this lease upon the same terms and provisions as those stated herein, for a further or additional period of twenty (20) years, and in the event of any such renewal, the minimum royalty for said renewal period shall be Four Thousand Dollars ($4,000.00) per year; provided the said Lessees, their heirs or assigns, shall give to the said Lessors, their heirs or assigns, at least thirty (30) days notice in writing of their intention and desire to renew said lease for said additional period of twenty (20) years, prior to the expiration of said twenty (20) year period.

XVII.

The Lessees shall deliver to the Lessors, their heirs or assigns, or one of them, within ten (10) days after the end of each six (6) months period, a blueprint of a map of the mines by a competent engineer, which shall show all coal mined by the Lessees during the last six (6) months period. Said blueprint shall show all the coal mined from the date of this lease up to the said last six (6) months period and shall also show the property lines of the leased premises.

XVIII.

It is understood and agreed between the parties hereto that in mining said coal or making any test holes or drilling any wells upon said premises for the purpose of investigating said land or mining said coal, the Lessees shall not be liable for any damages incurred by any cave-ins or the sinking of wells or springs or any other damage that might

be incurred in or by the said operations of the Lessees unless said damages be to the properties excepted as hereinbefore stipulated.

XIX.

It is further understood and agreed between the parties hereto that the said Lessees, their successors or assigns shall have the right to construct railroads, tramroads, haulroads, or tipples or other necessary structures upon said leased premises for the purpose of mining said coal and are also permitted to use any stone, dirt, water, trees or timber situate upon said premises for the purpose of mining said coal, except on those lands heretofore excepted, and shall make no payment therefor except the minimum royalties on the coal mined, hereinbefore provided for. It is further agreed between the parties hereto that the said Lessees, their heirs or assigns, may also have the same rights and privileges to the use of mining timber and other exceptions as were excepted on those tracts of surface sold and conveyed by the said • • •, now deceased, during his lifetime.

XX.

All of the aforesaid rights and privileges purported to be vested in the said Lessees are hereby granted under the terms hereof to the said Lessees, their heirs, successors and assigns, and all of the aforesaid immunities in favor of the said Lessees are and shall be in favor of the said Lessees, their heirs, successors and assigns.

This lease is executed in duplicate, • • •

XXI

The Lessors covenant that they will warrant generally the title to the coal, rights and privileges hereby leased and demised, and that they are free from encumbrances.

Witness the following signatures and seals.

• • • • • • • • • •

APPENDIX B

Form of Paragon Jewel Drift Mining Contract

THIS AGREEMENT, made this the .... day of ....., 19.., by and between Paragon Jewel Coal Company, Incorporated, a Virginia corporation, hereinafter referred to as Owner, party of the first part, and ...., hereinafter referred to as Contractor, party of the second part;

WITNESSETH:

WHEREAS, the Owner has acquired, either by purchase or lease, certain coal and the right and privilege of mining and removing the same from certain lands situate in Buchanan County, Virginia, and has heretofore had a verbal agreement with the Contractor who has been engaged as an independent contractor for the mining and placing in the tipple of the Owner, coal underlying said lands of the Owner; and

WHEREAS, the parties hereto desire to reduce to writing their said verbal agreement.

NOW, THEREFORE, for and in consideration of the covenants and agreements hereinafter made by the Owner, the said Contractor doth hereby covenant and agree as follows:

(1) To enter upon said lands of the Owner and to mine by the drift mining method in accordance with plans and specifications of the Owner, coal from the Jewell or Red Ash or such other seams of coal underlying said lands as the Owner may from time to time designate. It is understood and agreed that this is not and has not been an exclusive employment and that the designation of any coal to be mined and removed hereunder or which may have been heretofore designated to have been mined and removed has not and shall not give to the contractor the exclusive right to mine and remove the coal designated.

(2) To furnish all labor, materials, equipment and machinery which may be necessary or proper to mine, remove,

transport and place in the Owner's tipple, clean and merchantable coal mined by him hereunder in an efficient and workmanlike manner, and in complete compliance will all laws, State and Federal, now in effect or which may be hereafter enacted pertaining to the mining of coal.

(3) To take out and carry all liability and property damage insurance as will fully protect the parties hereto from any loss which may result to any person as the result of the operations contemplated hereunder, and also to take out and carry all such Workmen's Compensation insurance and unemployment or other insurance upon the employees of the Contractor as may be required by law, and to furnish unto the Owner such evidence that such liability and Workmen's Compensation insurance, or other insurance, is in effect at all times that the said Contractor may be carrying on his work pursuant hereto.

(4) The said contractor further covenants and agrees that he has looked and will continue to look solely to the personal covenant of the Owner for payment for the services heretofore rendered by him and which may be hereafter rendered by him in the mining of coal for the Owner; that he has never had and does not by virtue of this instrument acquire any economic interest in any of the coal which has been mined by him pursuant to said verbal agreement, or which may be hereafter mined by him hereunder; that the owner has had and shall continue to have the full right of percentage depletion deduction or other depletion deduction for income tax purposes or for any other purposes on all of the coal which has heretofore been or which shall hereafter be mined, produced, transported and delivered to the owner by the contractor hereunder; that the Contractor will make no claim for any percentage depletion deduction in any of his income tax returns, State or Federal, and, in the event it should be determined by any court or governmental agency, department or instrumentality, State or Federal, that he should be entitled to such percentage depletion deduction for tax purposes, he will repay to the Owner any sums that it may have lost on account of its failure to receive the whole of such per-

centage depletion deduction for tax purposes by virtue of such determination. The owner's sole right to such percentage or other depletion deduction for tax or other purposes have been taken into full account by the parties hereto in fixing the contract price hereunder.

The said Owner, in consideration of the covenants and agreements herein made by the Contractor, hereby covenants and agrees as follows:

(1) To pay unto the said Contractor the Sum of $..... per ton of 2,000 pounds for all coal mined by the Contractor hereunder and delivered to the tipple of the said Owner as herein provided, on or before Saturday of each week that the work herein contemplated shall be carried on by the Contractor. However, the Owner may alter the amount of compensation to be paid prospectively unto the Contractor for services thereafter rendered by him as contemplated herein from time to time without in any wise affecting the other provisions hereof. No such change in the amount of compensation shall be made unless and until Contractor shall have had at least three days' notice of same prior to the effective date thereof. Such payments for such services shall be based on weights at the scales located at the tipple of the Owner who shall deduct 2½% from such scale weights to cover tolerance, rejects, impurities and foreign matter in said coal, and the payments to be made to the Contractor by the Owner for his services hereunder shall be determined upon the difference between such scale weights and said 2½% deduction. The contractor shall have the right at all times to inspect the owner's scales and to test the same for accuracy.

(2) To construct and maintain all roads and power lines as may be necessary or expedient for the mining of said coal and delivering the same to the Owner's tipple.

(3) To provide and furnish all engineering services as may be necessary or proper for the mining of coal from the owner's lands and for delivering and transporting the same to the owner's tipple; it being understood between

the parties however, that the cost of certain engineering services incident to the contractor's operations have been and shall hereafter be deducted from the contract price for the coal mined by the contractor.

The parties hereto mutually covenant and agree that either may, without liability, terminate this agreement at will, with or without cause by giving to the other party notice in writing of his intention so to do. In the event of the termination of this agreement by either of the parties, the said Contractor shall have ten (10) days thereafter in which to remove from the Owner's lands all of his readily removable equipment, machinery, supplies and tools. In the event this agreement should be terminated without cause by the Owner while minable coal is still in existence upon the Owner's lands, the value of such structures or other improvements which have been placed upon the Owner's land by the Contractor as are not readily removable in the agreed amount of $..... will be paid for by the Owner at such agreed value, less normal depreciation from date of installation.

(4) The parties further mutually covenant and agree that title to all coal underlying the owner's lands is and shall remain in the owner and the contractor shall have no right to deliver or dispose of any coal produced by him from said lands to anyone other than to the owner.

It is further agreed between the parties hereto that at all times the owner shall have the right to inspect the mining operations of the contractor in order to insure that the terms and provisions of this contract are being complied with.

IT IS FURTHER UNDERSTOOD AND AGREED by and between the parties hereto that the relationship between them is in every respect that of owner and independent contractor and that this contract shall be performed accordingly.

The contractor shall not have the right to transfer or assign this agreement or any part thereof without the written consent thereto by the owner first had and obtained.

WITNESS the following signatures as of the day and year first above written.

PARAGON JEWEL COAL COMPANY, Incorporated,
a Virginia corporation,

By .....

.....

Owner

.....

.....

.....

.....

Independent Contractor

218
305

FILE COPY

Office-Supreme Court, U.S.
FILED
FEB 16 1959
JAMES R. BROWNING, Clerk

Nos. 218 and 305

In the Supreme Court of the United States

OCTOBER TERM, 1958

ELIOTT W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS, PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
DANIEL M. FRIEDMAN,
Assistant to the Solicitor General,
MARVIN W. WHISTLER,
Attorney,
Department of Justice, Washington 25, D.C.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and regulations involved	3
Statement:	
The facts	3
The decisions of the courts below	13
Summary of argument	15
Argument:	
Taxpayers are not entitled to percentage depletion deductions on their gross income from strip mining operations	20
A. The depletion deduction is designed to permit the tax-free recovery of a capital investment in a wasting asset which is exhausted through extraction. It is not intended to provide an incentive for the development of mineral resources, or to compensate for risks inherent in the mining industry	22
B. In order to obtain a depletion allowance, a taxpayer must have a capital investment in the mineral in place. A mere economic advantage derived from production is not sufficient	24
C. Petitioners had no capital investment in the coal in place; they had merely an economic advantage derived from production	31
Conclusion	40
Appendix	41

CITATIONS

Cases:	
Anderson v. *Helvering*, 310 U.S. 404	27
Burnet v. *Guggenheim*, 288 U.S. 280	33
Burnet v. *Harmel*, 287 U.S. 103	22
Burton-Sutton Oil Co. v. *Commissioner*, 328 U.S. 25	26

496789—59——1

Cases—Continued

	Page
Clifton v. *Commissioner*, decided April 21, 1958 (T.C.)	37
Commissioner v. *Estate of Holmes*, 326 U.S. 480	33
Commissioner v. *Hamill Coal Corp.*, 239 F. 2d 347	37
Commissioner v. *Mammoth Coal Co.*, 229 F. 2d 535, certiorari denied, 352 U.S. 824	36
Commissioner v. *Southwest Expl. Co.*, 350 U.S. 308	15, 16, 20, 21, 22, 23, 24, 26, 28–29, 30, 31, 35, 37, 39
Fink v. *Commissioner*, 29 T.C. 1119	37
Helvering v. *Bankline Oil Co.*, 303 U.S. 362	16, 17, 22, 23, 27, 31, 36
Helvering v. *O'Donnell*, 303 U.S. 370	28
Helvering v. *Twin Bell Syndicate*, 293 U.S. 312	19, 23, 39
Herring v. *Commissioner*, 293 U.S. 322	31
Hughes, C.A., & Co. v. *Commissioner*, decided March 9, 1955 (T.C.)	37
Kirby Petroleum Co. v. *Commissioner*, 326 U.S. 599	16, 27, 31
Lynch v. *Alworth-Stephens Co.*, 267 U.S. 364	25
Morrisdale Coal Mining Co. v. *Commissioner*, 19 T.C. 208	37
North Range Mining Co. v. *Commissioner*, 46 B.T.A. 296	39
Palmer v. *Bender*, 287 U.S. 551	16, 20, 25, 26, 31
Stilwell v. *United States*, 250 F. 2d 736	36, 37
Thomas v. *Perkins*, 301 U.S. 655	27
United States v. *Ludey*, 274 U.S. 295	23
Usibelli v. *Commissioner*, 229 F. 2d 539	24, 36
Weirton Ice & Coal Sup. Co. v. *Commissioner*, 231 F. 2d 531	37

Statutes:

Internal Revenue Code of 1939: Page

Sec. 23 (a) 26 U. S. C. 1952 ed., Sec. 23(a)..... 38

Sec. 23(l) (26 U.S.C. 1952 ed., Sec. 23(l))..... 38

Sec. 23(m) (26 U.S.C. 1952 ed., Sec. 23(m))..... 3, 15, 20, 39, 41

Sec. 111(a) (26 U.S.C. 1952 ed., Sec. 111(a))..... 38

Sec. 113(a) (26 U.S.C. 1952 ed., Sec. 113(a))..... 38

Sec. 113(b) (26 U.S.C. 1952 ed., Sec. 113(b))..... 38

Sec. 114(a) (26 U.S.C. 1952 ed., Sec. 114(a))..... 38

Sec. 114(b) (26 U.S.C. 1952 ed., Sec. 114(b))..... 3, 15, 20, 39, 42

Sec. 166 (26 U.S.C. 1952 ed., Sec. 166)..... 33

Sec. 167 (26 U.S.C. 1952 ed., Sec. 167)..... 33

Sec. 811(d) (26 U.S.C. 1952 ed., Sec. 811(d))..... 33

Miscellaneous:

G.C.M. 26290, 1950–1 Cum. Bull. 42..... 3, 32, 37

Treasury Regulations 111, Sec. 29.23(m)–1..... 3, 30, 42

In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 218

EMORY W. PARSONS, ERMA M. PARSONS, HOWARD H. PARSONS, ET AL., PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

No. 305

GEORGE HUSS, RUSSELL HUSS AND WESLEY HUSS, PETITIONERS

v.

FRANCIS R. SMITH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

Parsons, No. 218. The opinions of the Court of Appeals affirming the decision of the District Court (R. 33–39), and denying rehearing (R. 47), are reported at 255 F. 2d 595. The findings of fact, con-